UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

In re: JEFFERSON COUNTY, ALABAMA, a political subdivision of the State of Alabama, Debtor.	Chapter 9 Case No. 11-05736-TBB

TRIAL BRIEF OF THE BANK OF NEW YORK MELLON, AS INDENTURE TRUSTEE, IN SUPPORT OF THE MOTION OF THE TRUSTEE FOR ORDER GRANTING RELIEF FROM THE AUTOMATIC STAY, OR, IN THE ALTERNATIVE, ADEQUATE PROTECTION

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The Bank of New York Mellon, as indenture trustee (the "***Trustee***")[1] for the special revenue sewer warrants issued by Jefferson County, Alabama (the "***County***") in the original principal amount of approximately $3.6 billion (the "***Warrants***")[2] pursuant to the terms of that certain Trust Indenture, dated as of February 1, 1997 (as supplemented, the "***Indenture***"),[3] respectfully files this brief in support of its *Motion of Trustee for Order Granting Relief from the Automatic Stay, or, in the Alternative, Adequate Protection* [Dkt. No. 1390] (the "***Motion for Relief***"). This brief incorporates the factual discussion and arguments set forth in the Motion for Relief, and responds to the multi-prong legal and factual arguments the County has asserted in an attempt to deprive the Trustee and holders of the Warrants (collectively, the "***Warrantholders***") of the System Revenues to which they are entitled[4] under the Indenture and applicable bankruptcy[5] and non-bankruptcy law.[6]

INTRODUCTION

When the County entered into the Indenture in February 1997, the County recognized its obligation under the Indenture to "provide for sufficient Net Revenue Available for Debt Service" and "adopted a resolution that amended its sewer rate ordinance (the "***Rate Adjustment***

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[1] The Trustee is informed that Assured Guaranty Municipal Corp. is filing a joinder and supplemental trial brief and joins in this trial brief to the extent set forth therein. The Trustee is further informed that the other movants join in this trial brief.

[2] As used herein, "Warrants" has the same meaning as the term "Parity Securities" in the Indenture (as defined herein).

[3] Capitalized terms used herein and not otherwise defined have the meanings ascribed to them in the Indenture.

[4] As discussed in greater detail below, the Trustee and Warrantholders have valuable property rights in the System Revenues ***and*** the financial covenants set forth in the Indenture requiring the County to set the System's rates at a level sufficient to pay the Indebtedness (as defined herein).

[5] The County cannot impair the special revenue Indebtedness under chapter 9, and Congress did not intend for chapter 9 to be used in this manner. The Trustee reserves all of its rights in respect of these issues.

[6] The County's arguments are set forth in *Jefferson County's Preliminary Response to the Sewer Creditors' Motion for Relief from the Automatic Stays with Respect to the Sewer Ratemaking Process* [Dkt. No. 1421] and *Jefferson County's Reply in Further Support of its Motion in Limine* [Dkt. No. 1598] (together, the "***County's Response***").

Resolution") to provide a procedure for annual adjustment to System rates." Jefferson Cnty. Comm'n Res. Dec-16-2008-1374. The County nevertheless failed to set rates in compliance with the Indenture and the Rate Adjustment Resolution. On September 16, 2008, the Trustee filed suit against the County due to a number of defaults, including payment defaults and the County's failure to raise the System's rates sufficiently to provide for payment of the Warrants.

Three months after suit was filed, the County reacted by suspending the Rate Adjustment Resolution. The County stated, "Suspending the Rate Adjustment Resolution will allow the Commission to act directly on System rates after consulting with and considering the recommendations of the Special Masters and the County's consultants." *Id*. The County asserted that such "action [was] necessary for the Commission to balance and discharge its duties to creditors, rate payers and the environment under the Indenture, the Consent Decree and applicable law." *Id.*

After 2008, the County repeatedly breached the Indenture and steadfastly refused to raise the System's rates. The County's breaches resulted in the Circuit Court for Jefferson County (the "***Circuit Court***") appointing a receiver (the "***Receiver***") with rate making powers on September 22, 2010. *See The Bank of New York Mellon v. Jefferson Cnty.*, No. 01-cv-2009-002318, Order, at 5, ¶ 15 (Ala. Cir. Ct. Sept. 22, 2010) (the "***Receivership Order***"). After performing an extensive analysis of the System and System Revenues, the Receiver proposed an interim rate increase of twenty-five percent (25%) in June 2011, which the Receiver intended to implement effective as of July 2011. *See Receiver's First Interim Report on Finances, Operations, and Rates of the Jefferson County Sewer System* [Dkt. No. 257, Exh. M40], at 55. The Receiver held its rate increase in abeyance while the County and the state of Alabama attempted to negotiate a global restructuring of the Indebtedness with the major sewer creditors.

Before commencing this case, the County commissioners (the "***Commissioners***") had agreed as part of a global settlement and refinancing transaction (which would have reduced the sewer debt by approximately $1 billion) to raise sewer rates by approximately 8.25% for each of three years, to be followed by annual rate increases not to exceed 3.25%. Instead of consummating the settlement, the County commenced this case on November 9, 2011. Ever since the County regained control of the System in January 2012 by virtue of the bankruptcy filing and the protection afforded by the automatic stay, the County has, as the Trustee feared, ignored its legal obligations and the findings of the Receiver and continued to delay necessary rate increases mandated by the Indenture and applicable non-bankruptcy law. Notably, had the increases gone into effect, rates would already have been increased by more than 17%. Quite clearly, the County's strategy is to minimize revenues available to pay the Indebtedness through litigation in an effort to force a future cram down. Thus, the County has sought to subordinate the payment of the Indebtedness to its legal fees, to capital expenditures, and to unreasonably large operating expenses, in addition to setting rates at artificially low levels. The County's theory seems to be that by breaching its duties to the Trustee and Warrantholders, it can intentionally depress the value of the System Revenues. The County has continued to use the automatic stay as a sword – rather than a shield – to orchestrate this litigation strategy designed to impair the System Revenues available to repay the Indebtedness now and in the future.

After Financial Guaranty Insurance Company filed the *Motion to Lift or Condition the Automatic Stay* [Dkt. No. 845], the Court directed the County to file interim reports on its rate setting efforts and the County subsequently conducted a rate setting process involving a number of public hearings – a practice not required under the Indenture or applicable law that, heretofore, the County had ***never*** engaged in prior to the announcement of a rate increase. At the

final hearing on the Motion for Relief, the Trustee will demonstrate that the County designed and implemented this process in a transparent attempt to imprint an appearance of formality onto what was nothing more than a litigation strategy designed to impair the value of the Trustee's and Warrantholders' collateral.

The Trustee will demonstrate that the goal of the County's rate setting process was not to "balance and discharge its duties to creditors, rate payers and the environment under the Indenture, the Consent Decree and applicable law[,]"[7] but to maximize the County's leverage in negotiating concessions from Warrantholders. The County's bankruptcy counsel, ***not the Commissioners***, are attempting to use the automatic stay as a cudgel to achieve an end result contrary to Alabama law and the Bankruptcy Code,[8] and the parties' agreement as expressed in the Indenture. The County's choreographed actions violate fundamental precepts of adequate protection to which the Trustee and Warrantholders are entitled, and the County's efforts to use the automatic stay to enable it to depress the value of the Trustee's and Warrantholders' collateral is, itself, cause for relief from the automatic stay.

During the June 12, 2012 public hearing, Commissioner Carrington stated that the Commissioners would not "prejudge anything before we have all the facts and the input of the public and our highly-qualified experts," and stated that "regardless of what ultimately – what's ultimately proposed as a result of these public hearings, we want everyone to be convinced that the process that this Commission undertook was fair, open and consistent with our state constitution." *First Periodic Status Report Concerning the Sewer Ratemaking Process* [Dkt. No.

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[7] *See* Jefferson Cnty. Comm'n Res. Dec-16-2008-1374.

[8] "Bankruptcy Code" shall mean title 11 of the United States Code. In addition, unless stated otherwise, all references to a "§" or "chapter" are to those sections and chapters in the Bankruptcy Code.

1070], Exh. A, June 12, 2012 Jefferson Cnty. Pub. Hrg. Transcr., 10:19-22, 12:2-7.[9] Rather than conducting its actions completely in public meetings and based solely upon the "record" to achieve a result consistent with Alabama law, in a series of closed door "executive sessions" the County's lawyers retained and managed experts to reach conclusions that did not consider the amounts of the Indebtedness or a maximum reasonable rate increase that could service the Indebtedness. The County's carefully orchestrated process led to the adoption of a predetermined and minimal (both in amount and term) rate increase based upon flawed and incomplete data in an attempt to avoid or delay an unfavorable stay relief ruling.

At the hearing, the Trustee will establish that the County made no effort to determine if there were reasonable sewer rates higher than the rate set by the Resolution or whether there were any reasonable rates that would enable the County to repay the full amount of the Indebtedness, did not take the cost of service – including the Indebtedness – into account at all in approving the new rate, and did not follow any established or recognized rate setting process. Indeed, the financial modeling prepared by the Trustee's experts will establish that the System can be operated with reasonable rates to repay the Warrants ***in full***.[10] The Trustee will present two revenue models that demonstrate that the System can, with reasonable rates, generate sufficient System Revenue to repay the Indebtedness and the costs of operating the System,[11]

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[9] Similarly, the County represented to this Court that "All of the public hearing transcripts, witness presentations, and materials submitted by interested parties are now being assembled into a single complete, official record (the "Record"), which will form the basis on which the Commission will act." *Third Periodic Status Report Concerning The Sewer Ratemaking Process* [Dkt. No. 1299], at 9.

[10] The Trustee's financial modeling also assumes that there is no consensual resolution between the County and the sewer creditors that results in a reduction of the outstanding principal on the Warrants.

[11] The County has asserted that the Trustee did not present rate models at the public hearing and, accordingly, is precluded from enforcing the Indenture or asserting that the County failed to comply with Alabama law. These assertions miss the point. The Indenture, which establishes the County's obligations in the Revenue Covenant, does not require the ***Trustee*** or any creditor to do anything – to the contrary, it requires the ***County*** to take particular actions. Even assuming, however, that the County's assertions were relevant, they are nonetheless wrong. A survey

requiring the County to increase System Revenues by approximately twenty-two percent (22%).[12] The Trustee's experts have determined that the needed rate increases are well within the level of recognized industry standards of reasonableness. If rates are not raised to these levels now, the County will not only harm the interests of the Trustee and Warrantholders by depriving them of the System Revenues to which they are entitled, but the County will also jeopardize its ability to address projected future capital expenses in the next five to ten years. Despite the County's obligations under § 12.5(a) of the Indenture (the "***Revenue Covenant***")[13] and Alabama law to set sewer rates based on the cost of service, including the Indebtedness owed, and despite this Court's admonition to the County in its previous ruling, that if adequate steps were not taken to increase revenues the Court would consider future stay modification,[14] the County chose a litigation strategy designed to maximize leverage, but minimize the System Revenues to the detriment of, and with no regard for, the Warrantholders' rights.

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by Trustee's counsel of Alabama case law regarding the reasonableness of utility rates has not revealed a single case in which presenting alternative rates at a public hearing was a prerequisite to establishing that a rate-setting body had failed to comply with Alabama law. Finally, the County's assertions disingenuously ignore that the creditors (the "***Invitees***") responded to the County's invitation to participate in the public hearings by, in turn, inviting the County's counsel to discuss future rate structures that the Invitees' counsel thought to be appropriate and advisable – an invitation that the County elected to ignore. *Response of Indenture Tr. & the Named Warrantholders & Insurers to Jefferson Cnty.'s Invitation to Address the Jefferson Cnty. Comm'n at the Next Sewer Rate Hrg.* [Dkt. No. 1131], at 5, ¶ 5. Furthermore, the Trustee provided the County with voluminous rate reports and studies.

[12] The Trustee currently intends to proffer two proposed revenue models at the final hearing on the Motion for Relief that will demonstrate that they System can, with reasonable rates, generate sufficient System Revenue to pay the Indebtedness and the costs of operating the System. These models provide for the repayment of the Warrants within the original amortization period. The Trustee is not asserting that these are the ***only*** two models that would adequately provide for the repayment of the Indebtedness in accordance with the Indenture and Alabama law.

[13] The Revenue Covenant is separate and distinct from the Rate Covenant, which is set forth in § 12.5(b) of the Indenture. As described in more detail, *infra*, the Rate Covenant (§ 12.5(b)) is a debt ratio covenant that is separate and apart from the County's obligation under the Revenue Covenant (§ 12.5(a)) to set rates at a level sufficient to pay the Indebtedness. The County ignores this distinction and wrongly argues that the Trustee cannot enforce the Revenue Covenant due to the acceleration of certain Warrants. The default provisions of the Indenture establish that the Trustee may seek to enforce the implementation of rates that are both achievable and reasonable.

[14] The evidence to be presented by the Trustee will show that the County has not heeded the Court's admonition.

For example, the County employed Mr. Eric Rothstein to assist with its rate hearings but defined the scope of his engagement in a manner that assured his recommended rates would be below rates based upon industry standards. Mr. Rothstein did not conduct a cost of service study, made no effort to determine actual revenue requirements and assumed the debt was presently indeterminable. Despite past testimony that he could create a rate structure in ninety (90) days that would provide for repayment of the Indebtedness in full, Mr. Rothstein made no effort to advise the County how it could reasonably and fairly maximize net System Revenues available to pay debt service.

Similarly, another of the County's experts, Dr. Stephanie Yates (formerly known as Dr. Rauterkus), was not employed in an effort to enhance System Revenues, but to analyze the impact of rate increases on low-income residents and to build a case to justify the County's decision not to implement any meaningful rate increases. While assistance to low income residents may be beneficial, it in no way prevents the County from implementing reasonable rates to service the Indebtedness. The two efforts are not mutually exclusive and public utilities regularly service their debts while also assisting low income residents.

Likewise, after the close of its public hearing, the County employed CH2M Hill to prepare an irrelevant report determining the cost of building new reduced-size treatment plants today using three years of historical data for the existing plants. Even though the report was not a factor in the Commission's rate decision and was not used by the County's rate consultant, it is discussed extensively in the resolution passed by the County on November 6, 2012 (the "***Resolution***"). The flawed report, designed to further a litigation strategy, fails to consider peak influent and effluent data available at the time the existing plants were built or expanded, fails to consider the conditions under which the existing plants were built or expanded, incorrectly

assumes that the plants would be built in "green field" conditions, and mistakenly assumes significantly reduced treatment capacity. These reduced-size plants could not possibly treat the peak flows that have been encountered at these plants and would result in serious danger to the public as well as violation of the Consent Decree. In short, the County's new rate structure is built on suspect data and analysis that further supports the conclusion that it was enacted as part of a litigation strategy to impair the value of the Trustee's and Warrantholders' collateral.

The County's actions continue to harm the Trustee and the Warrantholders by delaying necessary, feasible, and required rate increases. The Indenture and Alabama law require the System's rates to be raised to a level sufficient to service the Indebtedness; however, the County has set rates without regard to the amounts necessary to pay the Indebtedness. The Supreme Court of the United States long ago recognized that "[p]roperty may be as effectively taken by long-continued and unreasonable delay in putting an end to confiscatory rates as by an express affirmance of them." *Smith v. Ill. Bell Tel. Co.*, 270 U.S. 587, 590 (1926).[15] If not a taking here, at a minimum, the County has failed to provide adequate protection to the Trustee and Warrantholders. As explained more fully below, the County's failure to comply with its obligations under the Indenture and applicable law and to heed the admonition of this Court to increase System Revenues constitute cause to lift the automatic stay under §§ 362(d)(1) and 922(b).

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[15] The municipality in *Illinois Bell* managed to delay rate increases for two years. The Court found such action "evinces an entire lack of that acute appreciation of justice which should characterize a tribunal charged with the delicate and important duty of regulating the rates of a public utility with fairness to its patrons but a hand quick to preserve it from confiscation." *Ill. Bell Tel. Co.*, 270 U.S. at 590. The Trustee and Warrantholders have suffered artificially low rates for almost ***five years***.

ARGUMENT

As demonstrated by the County's Response, as well as its actions during this case, the County has engaged in its litigation strategy by advancing two main arguments. First, the County argues that enforcing the Revenue Covenant would somehow be an improper usurpation of the County's legislative authority and powers under the Bankruptcy Code. Second, the County mischaracterizes the relief available to the Trustee and Warrantholders under state law and the Indenture. The County makes these arguments in its attempt to set rates without regard for debt service requirements, ignoring the Revenue Covenant, Alabama law, and industry rate setting standards. The Trustee will demonstrate in this brief, and at the final hearing on the Motion for Relief, that the County's positions are untenable.

As set forth in the Motion for Relief and herein, cause exists to grant relief from the automatic stay. While "cause" is not defined in the Bankruptcy Code, the legislative history for § 362 provides guidance, stating that the lack of adequate protection is not the only "cause" for relief and, further, that "[t]he facts of each request will determine whether relief is appropriate under the circumstances." H.R. Rep. No. 95-595, at 344 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6300. Based upon the foregoing, courts have determined that "cause" is an intentionally broad, flexible concept permitting courts to address the specific exigencies of each case based upon a consideration of the totality of the circumstances. *See, e.g.*, *Brown v. Chestnut (In re Chestnut)*, 422 F.3d 298, 303 (5th Cir. 2005); *In re Fairchild Corp.*, No. 09-10899, 2009 WL 4546581, at *5 (Bankr. D. Del. Dec. 1, 2009); *In re Boodrow*, 192 B.R. 57, 60 (Bankr. S.D.N.Y. 1995).

The Trustee has valuable interests in the System Revenues generated by the System and a perfected lien on net System Revenues. The value of this revenue stream is protected by terms of the Indenture, including the Revenue Covenant, the Rate Covenant, and the requirements of

Alabama law. However, the County continues to damage the Trustee's and Warrantholders' property rights by: (i) ignoring its obligations under the Indenture and state law to charge sufficient sewer rates; and (ii) minimizing System Revenues rather than generating System Revenues sufficient to pay the Indebtedness, wholly ignoring its legal duties and obligations.[16] As a result, the County has failed and continues to fail to protect the Trustee's and Warrantholders' property rights and, indeed, has impaired those rights contrary to the terms of the Indenture, the dictates of Alabama law, the Bankruptcy Code, and the United States Constitution.[17] Contrary to a debtor's obligations under Alabama law and the Bankruptcy Code, the County is making no effort to repay the amounts owed under the Indenture. *Fano v. Newport Heights Irrigation Dist.*, 114 F.2d 563 (9th Cir. 1940); *Kelley v. Everglades Drainage Dist.*, 319 U.S. 415 (1943); *see also Wabash Valley Power Assoc. v. Rural Electrification Admin.*, 903 F.2d 445, 451 (7th Cir. 1990) ("A debtor in bankruptcy is supposed to maximize the value of the estate, which opposition to a rate increase does not.") (J. Easterbrook).[18] This failure is

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[16] A year ago, counsel for the County asserted it could withhold System Revenues from the Trustee and Warrantholders for depreciation, amortization, and attorney fees. In David Stern's letter to Gerald Mace, counsel for the Trustee, the County even stated "if we used the depreciation and amortization numbers from Exhibit M-102 (between $128 million and $130 million per year, meaning between $10-11 million per month), there would be nothing to remit." While the County did not take the position that it would withhold all System Revenues for certain depreciation, amortization and non-operating expenses, testimony during the § 928 trial established the County's intention to incur large capital expenditures during this case instead of taking the more prudent conservative approach recommended by the Receiver. Indeed, despite its admitted insolvency, the County's actions evince no concern for creditors' rights at all.

[17] For the sake of clarity, when the Trustee states that the County is impermissibly impairing the Trustee's and Warrantholders' property rights, the Trustee means that the County is seeking to provide the Trustee and Warrantholders with less than that to which they are entitled under non-bankruptcy law and the Bankruptcy Code.

[18] Notably, where the *Wabash Valley Power* debtor refused to raise rates due to a conflict of interests (*i.e.*, member-owners did not want to raise rates because they would be the ones paying them), Judge Easterbrook was "surprised that the bankruptcy judge ha[d] allowed [the debtor] to operate as debtor in possession, when the clash of interests . . . was so obvious." *Wabash Valley Power*, 903 F.2d at 451. Similarly, in *In re Cajun Electric Power Cooperative, Inc.*, the court found that it was impossible for the debtor in possession to properly act as a fiduciary of the estate and a fiduciary for its members where there was an obvious conflict of interests between the two regarding the raising or lowering of utility rates and, consequently, appointed a trustee. *In re Cajun Elec. Power Coop., Inc.*, 191 B.R. 659, 662 (M.D. La. 1995) (stating that "[t]here is little doubt that the lower the rates charged, the less revenue there will be to pay the outstanding debt in this case[; and, conversely], any rate increase which Cajun might

impairing the Trustee's property rights. As recognized by this Court, the Trustee and Warrantholders cannot be adequately compensated for the loss caused by the delay in receipt of what they are entitled to under the Indenture. *Memorandum Opinion* [Dkt. No. 509] (the "***Memorandum Opinion***"), at 43 n.16; *see also Ill. Bell Tel. Co.*, 270 U.S. at 591 (stating that property may be as effectively taken by a long and unreasonable delay in setting appropriate rates as by an express, affirmative taking).[19] The totality of the circumstances, including the County's orchestration of a managed public hearing process, demonstrates that cause exists to grant relief from the automatic stay pursuant to §§ 362(d)(1) and 922(b) to enable the Trustee to exercise the bargained-for remedies set forth in the Indenture to prevent further deprivation of its property rights. *La. World Exposition v. Federal Ins. Co.*, 858 F.2d 233, 249 (5th Cir. 1988) (debtor has fiduciary duty to maximize value of estate for the benefit of its creditors); *see also In re Midwest Props. of Shewano, LLC*, 442 B.R. 278, 285-86 (Bankr. D. Del. 2010) (in context of dismissal, finding cause as a result of debtor's failure to fulfill its fiduciary duties).

I. The County is attempting to improperly expand its governmental power.

The County's Response includes two separate legal arguments the goal of which is to invalidate the Revenue Covenant and impermissibly impair the Trustee's property rights. The County asserts that it has the sole authority to set sewer rates because (i) despite the language set forth in the Indenture and the Receivership Order, the power to set rates is a non-delegable legislative function reserved to the County, and (ii) once the County makes a rate setting

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seek is adverse to its members."), *vacated sub nom. Matter of Cajun Elec. Power Coop., Inc.*, 69 F.3d 746 (5th Cir. 1995), *opinion withdrawn in part on reh'g*, 74 F.3d 599 (5th Cir. 1996), *aff'd sub nom. Matter of Cajun Elec. Power Coop., Inc.*, 74 F.3d 599 (5th Cir. 1996). In appointing the trustee, the *Cajun Electric* court noted the importance of having a neutral person oversee the debtor in possession to avoid the appearance of impropriety in the bankruptcy case. *Cajun Elec.*, 191 B.R. at 662.

[19] In addition, as recognized by this Court, the longer the County delays appropriate rate modifications, the worse the situation becomes. May 3, 2012 Hrg. Transcr., at 11:15-12:5 [Dkt. No. 1003].

decision, a court cannot interfere with that decision unless the decision is arbitrary and capricious. Alabama courts and federal courts, including the United States Supreme Court, have repeatedly rejected similar attempts to argue that rate setting agreements, such as the Indenture, can be unilaterally changed.

A. The power to set rates in Alabama must comply with Alabama law and, once such power becomes subject to a contractual obligation, a municipality cannot use its governmental powers to avoid the obligation.

Alabama law allows a municipality to contractually obligate itself to exercise its power to set rates.[20] Once the County agreed to the rate setting obligations in the Indenture, the County was prohibited from using its governmental power to avoid or otherwise impair the obligation. Nevertheless, the County is now deploying the automatic stay to prevent the Trustee from acting to protect its interests while the County attempts to employ its alleged governmental powers to keep the System's rates at an artificially low level that, though politically tenable, is insufficient to pay the Warrants and inconsistent with its obligations under the Indenture and applicable law. The County's depression of the System's rates is in derogation of the County's obligations under the Revenue Covenant, and the County now seeks to invalidate the Revenue Covenant[21] to avoid charging higher sewer rates. The County's actions, inaction, and omissions impair the Trustee's property rights contrary to the Bankruptcy Code, Alabama law, and the United States Constitution.

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[20] Ala. Code § 11-28-2 (stating that a county commission may issue warrants and shall have the power to enter into and perform all contracts necessary or desirable to sell and issue warrants ***and to secure and provide for the payment thereof***); *see also* Ala. Code § 11-28-3 (stating that any covenants of any county relating to the pledge of funds for the payment of principal and interest on warrants are enforceable against the county issuing the warrants).

[21] The County borrowed $3.6 billion to fix and enhance the System pursuant to the Indenture, which incorporates an agreement to charge sufficient rates to repay the Indebtedness. The County now seeks to invalidate a central part of the financial agreement – the Revenue Covenant.

1. The County must comply with Alabama law.

The County is required to comply with Alabama law notwithstanding chapter 9 of the Bankruptcy Code. Section 903 provides that "[t]his chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality." 11 U.S.C. § 903; *see also In re Vallejo, Cal.*, 432 B.R. 262, 267 (Bankr. E.D. Cal. 2010) (noting that chapter 9 does not affect the power of a state to control its municipality); *In re Mt. Carbon Metro. Dist.*, No. 97-20215, 1999 WL 34995477, at *3 (Bankr. D. Colo. July 20, 1999) (same). Section 903, by its terms, prevents a chapter 9 debtor from consenting to a court order that would violate a state law. *In re N.Y.C. Off-Track Betting Corp.*, 434 B.R. 131, 140-41 (Bankr. S.D.N.Y. 2010) (citing 6 *Collier on Bankruptcy* ¶ 904.02[2][a] (observing that a "municipality could not, by its consent, empower the court to order the municipality to do an act that would be in violation of a law or administrative order of the state controlling its municipalities")). If a municipality cannot consent to a bankruptcy court ordering it to ignore state law, then it would defy logic if a municipality could ignore state law.[22] *Id.*; *see also Cont'l Air Lines, Inc. v. Hillblom (In re Cont'l Air Lines, Inc.)*, 61 B.R. 758, 780 (S.D. Tex. 1986) (citing 28 U.S.C. § 959(b)) ("Congress has explicitly expressed its intention that a debtor is not to have *carte blanche* authority to ignore nonbankruptcy law"); *Clancy v. Goldberg*, 183 B.R. 672, 675 (N.D.N.Y. 1995).[23]

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[22] It is also worth noting that the County only has the rights and powers delegated to it by the state of Alabama and, thus, cannot act beyond or outside such delegated rights and powers. *Birmingham Waterworks Co. v. City of Birmingham*, 211 F. 497, 501 (N.D. Ala. 1913) (citing *City of Bessemer v. Bessemer Waterworks*, 44 So. 663, 666 (Ala. 1907)).

[23] In addition to the requirements imposed by § 903, as set forth in the Motion for Relief, the Trustee also believes that 28 U.S.C. § 959 requires the County to comply with state law. However, the Trustee is cognizant of this Court's opinion regarding the applicability of 28 U.S.C. § 959 to the County and, accordingly, sets forth the Trustee's position briefly in this footnote for purposes of preserving the argument in the event of any appeal.

When the County entered into the Indenture, it became obligated under the terms of the Indenture and governing Alabama law – namely, Amendment 73,[24] Act 619,[25] and Chapter 28 of Title 11 of the Alabama Code – and, under Alabama law, the Trustee obtained property rights in those very obligations. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25 n.23 (1977) (stating a municipality acts as a person when it borrows money and contracts to repay it with interest) (citing *Murray v. Charleston*, 96 U.S. 432, 445 (1878)); *see also id.* at 17 n.14, 19 n.17 (contractual provisions with a municipality are informed and supplemented by the relevant local law in effect at the time of contracting). Thus, the County incurred obligations fixed by the Indenture, Amendment 73, Act 619, and Chapter 28 of Title 11 of the Alabama Code – notably, the obligation to fix the System's rates at a level sufficient to pay the Indebtedness – and was prohibited from using its governmental powers to impair or avoid such obligation.

2. The County may not use its governmental powers to avoid its obligations or otherwise impair the Trustee's rights under the Indenture.

The County argues that it may avoid the obligations it incurred under the Indenture and Alabama law. The County is wrong. The County confuses the prohibition against using its governmental powers to avoid or otherwise impair its contractual obligations with the general power under the Bankruptcy Code to adjust obligations. Through the County's rate setting process, the County is not attempting to adjust the Warrantholders' and Trustee's obligations ***under the Bankruptcy Code***; the County is impairing the Trustee's and Warrantholders' constitutionally and statutorily protected property rights ***behind the Bankruptcy Code*** – *i.e.*, ***under state law*** – by refusing to set appropriate rates and claiming their "legislative" rate making

[24] Ala. Const. Amend. 73.

[25] 1941 Ala. Acts, No. 619.

decisions cannot be challenged by the Trustee or Warrantholders. Nothing in the Bankruptcy Code permits the County to act in blatant disregard of Alabama law in this situation. In setting new rates, the County has acted as if the Indebtedness either does not exist or is unquantifiable. While the County purports to rely on §§ 506(a), 901(a), 927, and 1129(b) to assert that "the Bankruptcy Code permit[s] the County to adjust the amount of sewer debt," the County is not attempting to use any of these sections of the Bankruptcy Code, but rather is engaged in a transparent attempt to impair the Trustee's property rights in the net System Revenues under the Indenture by refusing to raise rates to a level sufficient to pay the Indebtedness. This result is prohibited by Alabama law and no provision of the Bankruptcy Code authorizes the County's actions.

Once a contractual obligation is undertaken by a municipality, the municipality may not use its governmental power to avoid the obligation or otherwise constitutionally impair the value of the property right attendant thereto. *Von Hoffman v. City of Quincy*, 71 U.S. 535, 555 (1866); *see also U.S. Trust Co.*, 431 U.S. at 24 n.22; *Perry v. Town of Samson*, 11 F.2d 655, 657-58 (M.D. Ala. 1926). Under Alabama law, it is well-settled that when a municipality incurs debt and agrees to pay the principal thereof and interest thereon, the law and methods of payment existing at the time forms part of the obligation, and no legislation thereafter may impair the right or duty to meet the obligation. *Perry*, 11 F.2d at 657.[26] Indeed, Alabama courts have consistently required municipalities to honor rate commitments and commitments to levy taxes to support indebtedness they incurred. *See, e.g.*, *Bd. of Rev. of Shelby Cnty. v. Farson, Son &*

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[26] Citing *Port of Mobile v. Watson*, 116 U.S. 289 (1886); *Louisiana ex rel. Nelson v. Police Jury of the Parish of St. Martin*, 111 U.S. 716 (1884); *Ralls Cnty. Ct. v. United States*, 105 U.S. 733 (1881); *Edwards v. Kearzey*, 96 U.S. 595 (1877); *Butz v. City of Muscatine*, 75 U.S. 575 (1869); *Von Hoffman*, 71 U.S. at 535; *Graham v. Quinlan*, 207 F. 268 (6th Cir. 1913); *City of Cleveland v. United States*, 166 F. 677 (6th Cir. 1909); *Hicks v. Cleveland*, 106 F. 459 (4th Cir. 1901); *Padgett v. Post*, 106 F. 600 (4th Cir. 1901); *City of Ensley v. Simpson*, 50 So. 61 (Ala. 1909); *Edwards v. Williamson*, 70 Ala. 145, 152 (1881).

Co., 72 So. 613, 615-16 (Ala. 1916); *Bessemer*, 44 So. at 668-69; *Birmingham Waterworks*, 211 F. at 497. Alabama courts have unequivocally held that a governing body cannot legislate around such commitments. *See, e.g.*, *Jefferson Cnty. v. City of Leeds*, 675 So. 2d 353, 354 (Ala. 1995); *Bessemer*, 44 So. at 669.

In *Bessemer*, the City of Bessemer and Bessemer Waterworks entered into a contract under which Bessemer Waterworks agreed to make improvements to its physical facility in exchange for the right to set and collect water rates at a level that did not exceed a fixed cap. *Bessemer*, 44 So. at 665-66. The City of Bessemer passed a later ordinance without the consent of Bessemer Waterworks, reducing the cap on rates that could be charged. *Id.* at 665. Bessemer Waterworks commenced an action against the City of Bessemer alleging, among other things, that the ordinance impaired its rights under the contract with the city and deprived the company of property in violation of the United States Constitution. *Id.* at 665-66. The Supreme Court of Alabama ruled in favor of Bessemer Waterworks, stating:

> [A] city may by contract fix rates at which water shall be supplied for a definite period, and in this way suspend its power to fix rates during the period prescribed in the contract . . . .
>
> . . . .
>
> [T]he conclusion is that the company has a valid contract with the city, and under it a ***vested right*** to charge for water that may be supplied at rates not exceeding the maxima named therein, and that the ordinance which attempts to reduce these rates ***impairs*** the obligation of the contract.

Id. at 667-69 (emphases added).

Even action by the state of Alabama cannot impair or otherwise frustrate a municipality's financial obligations regarding revenue generation. In *Perry*, at the time the municipality incurred its obligations, the Alabama constitution authorized taxes to be levied "on the value of the taxable property within [Alabama]." *Perry*, 11 F.2d at 657. Sometime after incurring of the

town's obligations, the Alabama Constitution was amended to provide that the taxable property within Alabama was to be assessed at only sixty percent (60%). *Id.* Because the legislation was enacted after the incurrence of the obligations by the town, and because the legislation impaired the lender's property rights, the *Perry* court found that it had the power to direct the town to levy the tax it had the power to levy, and had agreed to levy, at the time of incurring the obligations. *Id.* at 657-58. The *Perry* court issued writ of mandamus requiring the town to levy and collect the tax based on the full value of the property despite the change in state law. *Id.* at 659.

In *Farson*, the Supreme Court of Alabama recognized that the revenue derived from a special tax was pledged (like the System Revenues) to the repayment of warrants and stated:

> We are of the opinion, however, that as the commissioners' court had full power to enter into the contract and agree to levy this special tax for this particular purpose, and that as such agreement is valid and binding ***and a most material part of the contract***, it became the legal duty of the court to levy the tax and have the money so collected appropriated to the purpose for which it was pledged. The contract being binding, ***the question passed beyond the field of discretion and became one of plain duty to carry out the agreement solemnly made***.

Farson, 72 So. at 615 (emphasis added).

The Supreme Court of the United States has also held that a municipality is prohibited from using its governmental powers to avoid its financial obligations. In *Watson*, the City of Mobile, Alabama failed to pay its obligations under certain bonds. *Watson*, 116 U.S. at 299. After entry of a judgment against the city seeking to enforce, among other things, the City of Mobile's obligations to levy and collect annually a tax to pay the bonds, the commissioners of the city voted to vacate and annul the city's charter and incorporate the port of Mobile in an attempt to avoid the debt on the bonds, leaving the bonds unsatisfied with no source for repayment. *Id.* Upon review, the Supreme Court of the United States found that the port of Mobile was still obligated on the bonds, explaining:

> The laws which establish local municipal corporations cannot be altered or repealed so as to invade the constitutional rights of creditors. So far as such corporations are invested with subordinate legislative powers for local purposes, they are the mere instrumentalities of the states, for the convenient administration of their affairs, and are subject to legislative control. But when . . . they issue their bonds . . . to carry out any other authorized contract . . . they are, to that extent, to be deemed private corporations, and their obligations are secured by all the guaranties which protect the engagements of private individuals. Therefore ***the remedies for the enforcement of such obligations assumed by a municipal corporation, which existed when the contract was made, must be left unimpaired by the legislature, or, if they are changed, a substantial equivalent must be provided.*** Where the resource for the payment of the bonds of a municipal corporation is the power of taxation existing when the bonds were issued, any law which withdraws or limits the taxing power, and leaves no adequate means for the payment of the bonds, is forbidden by the constitution of the United States, and is null and void. ***These propositions receive strong support from the decisions of the supreme court of Alabama.***

Id. at 304-05 (emphasis added) (citing, among other things, *Comm'rs Ct. of Limestone Cnty. v. Rather*, 48 Ala. 433 (1872); *Edwards*, 70 Ala. at 145; *Slaughter v. Mobile Cnty.*, 73 Ala. 134 (1882)); *see also Howard v. State ex rel. McGarry*, 146 So. 414, 418 (Ala. 1933) (same). The *Watson* court held that all laws enacted to remove or impair the ability to pay the bonds were "invalid and ineffectual, and [to] be disregarded." *Watson*, 116 U.S. at 305.[27]

This holding was later reaffirmed by the Supreme Court of the United States. In *United States Trust Co.*, in conjunction with the issuance of certain bonds, a 1962 covenant restricted the subsidization of rail passenger transportation through the use of revenues and reserves pledged as security for the bonds. *U.S. Trust Co.*, 431 U.S. at 1. New York and New Jersey subsequently repealed the covenant. *Id.* at 1. The United States Supreme Court found that the repeal of the

[27] In so holding, the *Watson* court noted with approval its prior jurisprudence treating legislation as invalid and void where the legislation abrogated or otherwise restricted the power of taxation delegated to a municipality where such power formed the basis of contracts under which such power was the sole source of payment. *Watson,* 116 U.S. at 305-06 (citing *Wolff v. New Orleans*, 103 U.S. 358, 365-66 (1880); *Ralls Cnty. Ct.*, 105 U.S. at 736-37).

financial covenant completely eliminated an important security provision, thus impairing the obligation. *Id.* at 19; *see also id*. at 20 (citing with approval the trial court's ***finding that the repeal of the covenant impaired the Trustee's property rights*** because it permitted a diminution of the monies pledged to the repayment of the obligations). The *U.S. Trust Co.* court added that the security provision was a form of property held by the trustee and bondholders. *Id.* at 19 n.16 (citing *Contributors to Pa. Hosp. v. Phila.*, 245 U.S. 20 (1917); *El Paso v. Simmons*, 379 U.S. 497 (1965)). The *U.S. Trust Co.* court further observed that it had regularly held that the states are bound by their debt contracts. *Id.* at 24.[28] The Court thus found the repeal of the covenant by New York and New Jersey to be an unconstitutional impairment of the trustee's property rights.

Courts have also held that a municipality cannot violate state law to artificially impair or otherwise avoid valid financial obligations. In *Huidekoper v. Hadley*, 177 F. 1 (8th Cir. 1910), a county issued bonds that were to be paid by a tax levied upon the assessed value of the taxable property of the county and, otherwise, by participation with other creditors in the proceeds of a tax authorized for general county purposes. *Id.* at 3. The county defaulted on certain of the bonds and the holder thereof obtained a judgment against the county. *Id.* The tax revenues collected for general county purposes were wholly inadequate to pay the amounts owed on the bonds, and the county, along with the state, intentionally failed to assess the property of the county at its true value to prevent the creation of a fund to pay the indebtedness the bonds. *Id.* The *Hadley* court observed that the state and county (like the County in this case) were violating state law by artificially depressing property values in order to avoid paying the bonds. *Id.* The

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[28] *See also U.S. Trust Co.*, 431 U.S. at 24 n.22 (stating that state laws authorizing the impairment of municipal bond contracts have been held unconstitutional) (citing *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935); *Louisiana v. Pilsbury*, 105 U.S. 278 (1882)).

Hadley court held that the county and state were prohibited from intentionally violating the law in order to depress the County's ability to generate revenue for the purpose of impairing the ability to pay the county's obligations, and directed that a writ of mandamus be issued upon remand, requiring the state and county to comply with the laws in order to generate tax revenue sufficient to pay the bonds. *Id.* at 10-13.

These cases make clear that once a municipality incurs obligations payable from a specified source, the municipality cannot thereafter use its governmental powers to avoid the obligations or otherwise impair its ability to pay those obligations. To the extent a municipality attempts to legislate around such obligations, the legislation itself is invalid and ineffectual, and should be disregarded. *See, e.g.*, *Watson*, 116 U.S. at 305; *see also U.S. Trust Co.*, 431 U.S. at 24 n.22. Similarly, a municipality is also prohibited from violating state law in order to shirk its obligations. *Hadley*, 177 F. at 10-13. Because the County incurred the Indebtedness, pledged the System Revenues to the repayment of the Indebtedness consistent with and pursuant to Alabama law,[29] and bound itself to the terms of the Indenture (including the Revenue Covenant), the County cannot now use its governmental powers (or violate state law) to avoid the Indenture's mandates or otherwise impair the revenue stream derived from the System – *i.e.*, the System Revenues. No provision of the Bankruptcy Code changes this result.

3. The County's obligations under Alabama law have not been preempted by the Bankruptcy Code.

The County's obligations under Alabama law are not preempted by the Bankruptcy Code. It is well-established that the United States Constitution invalidates state law that interferes with or is contrary to federal law. *See, e.g.*, *Hillsborough Cnty., Fla. v. Automated Med. Labs., Inc.*,

[29] The Indenture and Warrants issued under it were validated by the Alabama Circuit Court for Jefferson County. *See Jefferson Cnty., Ala*., *v. Taxpayers & Citizens of Jefferson Cnty., Ala.*, No. CV 01-04657, Findings of Fact, Conclusions of Law & Final Judgment, at 3-15 (Ala. Cir. Ct. Aug. 24, 2001) (the "***Validation Order***").

471 U.S. 707, 712 (1895). Federal preemption takes three forms: (i) express preemption; (ii) field preemption; and (iii) conflict preemption. *Id*. at 713. As recognized by the United States Supreme Court, the Bankruptcy Code does not expressly or impliedly preempt state law. *Butner v. United States*, 440 U.S. 48, 54 (1979); *see also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 546 (1994) ("The Bankruptcy Code can of course override [state law] by implication when the implication is unambiguous. Where the intent to override is doubtful, our federal system demands deference to long established traditions of state regulation."). There is a "presumption against preemption" rooted in respect for states as independent sovereigns in our federal system. *See, e.g., Wyeth v. Levine*, 555 U.S. 555, 565 n.3 (2009).[30] "[W]hen the text of a pre-emption clause is susceptible [to] more than one plausible reading, courts ordinarily 'accept the reading that disfavors pre-emption.'" *Farina v. Nokia Inc.*, 625 F.3d 97, 118 (3d Cir. 2010) (citing *Altria Group, Inc. v. Good*, 555 U.S. 70 (2008)), *cert. denied*, 132 S.Ct. 365 (2011). In order to be preempted, Alabama law must directly interfere, or otherwise conflict, with the Bankruptcy Code.[31] It does not.

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[30] This presumption is even stronger in areas of traditional state regulation, such as sewer regulation and operation. It is true that both the Ninth Circuit and the Third Circuit have held that § 1123(a), portions of which have been incorporated into chapter 9 pursuant to § 901(a), preempts state law by establishing the contents of a bankruptcy plan "[n]otwithstanding any other applicable provision of nonbankruptcy law." *Pac. Gas and Elec. Co. v. ex rel. Cal. Dep't of Toxic Substances Control*, 350 F.3d 932, 937 (9th Cir. 2003) (finding that pursuant to § 1123(a) "nonbankruptcy law is expressly preempted by a reorganization plan only to the extent that such law 'relat[es] to financial condition'"); *In re Federal-Mogul Global Inc.*, 684 F.3d 355, 374 (3d Cir. 2012) (finding that § 1123(a) preempts all state laws conflicting with its provisions). Although any plan of adjustment in this case could have preemptive effect with respect to conflicting state laws, as noted by the Third Circuit, the express terms of § 1123(a) do not displace other Bankruptcy Code provisions. *Federal-Mogul*, 684 F.3d at 371. Because chapter 9 and specifically §§ 903 and 928(a) place state laws applicable to special revenues outside of the Bankruptcy Code, the state law provisions applicable to such special revenues likewise should not be preempted by § 1123(a). Indeed, the structure and legislative history of chapter 9 express Congress' intent that special revenue obligations would remain unimpaired. *See* S. Rep. No. 100-506, at 12-13 (1988) (stating that amendments to chapter 9 insure that revenue bondholders will have unimpaired rights to the project revenues pledged to them); *see also* H. Rep. No. 100-1011, at 4122 (1988).

[31] Indeed, the structure and legislative history of chapter 9 express Congress' intent that special revenue obligations would remain unimpaired. *See* S. Rep. No. 100-506, at 12-13 (1988) (stating that amendments to chapter 9 insure that revenue bondholders will have unimpaired rights to the project revenues pledged to them); *see also* H.R. Rep.

a. Neither Alabama law nor the Indenture interfere or conflict with any specific provision of the Bankruptcy Code.

Alabama law, which both recognizes the validity of the Revenue Covenant and requires that sewer rates to be based, in part, on the System's debt obligations, does not directly interfere, or otherwise conflict, with any provision of the Bankruptcy Code. The County has not identified, and cannot identify, a provision of the Bankruptcy Code that conflicts with a specific Alabama state law, nor can it argue that enforcement of the Revenue Covenant or other financial covenants stands as a complete obstacle to accomplishment and execution of the purposes and objectives of Congress.[32] While Alabama law prohibits the County from circumventing or otherwise impairing its obligation to pay the Indebtedness, it does not prevent the County from achieving a successful adjustment of its debts under chapter 9. The County is fully capable of proposing a confirmable plan of adjustment while still complying with the Indenture and Alabama law requiring the County to honor its obligation to set sewer rates sufficient to pay the Indebtedness in full as required by the Indenture and, as discussed below, consistent with protections afforded special revenue financing under chapter 9.

The County has raised the argument that the relief sought by the Trustee and other movants conflicts with § 365; however, nothing in the Indenture or the relief sought conflicts with § 365. Section 365(a) authorizes a debtor to assume or reject executory contracts. 11 U.S.C. § 365(a). Executory contracts have been characterized as those with "reciprocal remaining obligations." *See Gibson v. Resolution Trust Corp.,* 51 F.3d 1016, 1023 (11th Cir.

No. 100-1011, at 4122 (1988). Thus, rather than interfering or conflicting with Alabama law, the provisions of chapter 9, particularly as they relate to special revenue obligations, are in accord with Alabama law.

[32] *Cf. In re Cnty. of Orange*, 191 B.R. 1005 (Bankr. C.D. Cal. 1996) (basing preemption on ***direct conflict*** between state law creating special class of creditors and priority scheme outlined in Code provisions); *In re Vallejo*, 403 B.R. 72, 77 (Bankr. E.D. Cal. 2009) (relying upon ***express conflict*** between § 365 concerning authority to reject executory contracts and state law restricting debtor's ability to reject or impair obligations under collective bargaining agreements).

1995) (citations omitted); *see also In re Health Science Prods., Inc.*, 191 B.R. 915, 916 (Bankr. N.D. Ala. 1995) (stating that, once performance is only due from one party, a contract ceases being executory); *see also* Vern Countryman, *Executory Contracts in Bankruptcy: Part I,* 57 Minn. L. Rev. 439, 460 (1973) (stating that a contract is executory where the obligations of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.). "[W]here the contractual obligations of the bankrupt and the other contracting party remain at least partially and materially unperformed at bankruptcy, the contract is executory." *Jenson v. Continental Fin'l Corp.*, 591 F.2d 477, 481 (8th Cir. 1979).

Where the obligor under a trust indenture is the debtor, the trust indenture and financial covenants contained therein are not executory contracts. *See, e.g.*, *In re Acceptance Ins. Cos., Inc.*, No. BK05-80059, Order [Dkt. No. 96] (Bankr. D. Neb. May 26, 2005); *In re PWS Holding Corp.*, No. 98-212, 2002 WL 32332066, at *2 (Bankr. D. Del. Jan. 30, 2002) (finding that an indenture was not an executory contract because there were no duties or obligations owed to the debtor); *see also In re St. Vincent's Catholic Med. Ctrs. of N.Y.*, 440 B.R. 587, 601 (Bankr. S.D.N.Y. 2010) (loan documents are not executory contracts). As recognized by the *Acceptance Insurance* court, once the funds have been raised under an indenture, the holders of the municipal debt have already fully performed by paying for the notes and the indenture trustee owes no continuing obligations to the issuer, leaving only the debtor's obligations outstanding. Like in *Acceptance Insurance*, in this case, there are no bilateral obligations between the Trustee or Warrantholders and the County. The only obligations still outstanding are those obligations

owed ***by the County*** to the Trustee and Warrantholders. Accordingly, the Indenture is not an executory contract and, therefore, cannot be rejected.[33]

Nor are the Trustee's and Warrantholders' property rights "dischargeable."[34] The County confuses the Trustee's and Warrantholders' vested property rights under the Indenture with unsecured claims subject to discharge. In this case, the County pledged and imposed a trust (and impressed a lien) on the net System Revenues. Indenture, § 2.1(I); Ala. Code § 11-28-3 (stating that pledged funds shall constitute a trust fund impressed with a lien). While unsecured claims of general obligation creditors may be subject to adjustment and discharge, the lien and rights of special revenue creditors in a chapter 9 case are not subject to such treatment.[35] It has long been held that liens ride through a bankruptcy unaffected unless expressly avoided. *See, e.g.*, *Johnson v. Home State Bank*, 501 U.S. 78 (1991); *see also* 11 U.S.C. § 524(a). Furthermore, rights in trust funds are not subject to alteration or impairment. *See In re Monterey House, Inc.*, 71 B.R. 244, 247 (Bankr. S.D. Tex. 1986) ("That the corpus of a trust is not property of the estate is so widely accepted as to be beyond dispute." (quoting *In re Fresh Approach, Inc.*, 51 B.R. 412, 419 (Bankr. N.D. Tex. 1985)); *Matter of Quality Holstein Leasing*, 752 F.2d 1009, 1013 (5th Cir. 1985) ("Congress did not mean to authorize a bankruptcy estate to benefit from property that the

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[33] In *Jefferson Cnty's Reply in Further Support of Its Motion in Limine* [Dkt No. 1598] (the "***Limine Reply***"), the County improperly cites the decision of *In re City of Col. Springs Spring Creek Gen. Improvement Dist.*, 187 B.R. 683 (Bankr. D. Colo. 1995), for the proposition that a chapter 9 debtor can impair unperformed rights under a trust indenture. The *Colorado Springs* decision does not stand for this proposition, but rather held that parties could, through a consensual plan, do that which they were able to do outside of the bankruptcy process. The mere implementation of a consensual plan is not comparable to an attempt to substantively impair a creditor's property rights through a non-consensual plan.

[34] In the Limine Reply, the County argues in error that, even if the Indenture is not an executory contract (and it is not), "whatever rights the sewer creditors had under [the Indenture] would give rise to dischargeable 'claims,' . . . not mandates that are specifically enforceable postpetition. *Id.* at 7 n.9.

[35] The Trustee's rights under the Indenture and the trust funds pledged are not the type of obligations chapter 9 envisioned permitting a debtor municipality to discharge. *See* S. Rep. No. 100-506, at 6-7, 12 (stating there is a concern that pledged revenues could be diverted and amendments seek to redress such concern and assure that holders of special revenue instruments receive the benefit of their bargain – *i.e.*, unimpaired rights to the pledged revenue).

debtor did not own."). As a result, the County is wrong when it asserts that the Trustee's and Warrantholders' property rights are "dischargeable." Thus, there is no direct or express conflict between any provision in the Bankruptcy Code and any provision under Alabama law or the Indenture.

b. Neither Alabama law nor the financial covenants in the Indenture conflict with chapter 9.

Alabama law, with respect to the Revenue Covenant and the proper rate base for setting sewer rates, is not in conflict with the goals and purposes of chapter 9. As recognized by the Supreme Court of the United States, the intent of Congress is the "ultimate touchstone" for preemption analysis. *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996). In discerning this intent, courts look not only at Congress' express statements but also to the "structure and purpose of the statute as a whole, as revealed not only in text, but through the reviewing court's reasoned understanding of the way in which Congress intended the statute and its surrounding regulatory scheme to affect business, consumers, and the law." *Id.* at 486.

While chapter 9 provides a process for insolvent municipalities to address certain issues, Congress enacted certain provisions of chapter 9 to ensure that the rights of special revenue creditors would remain unimpaired in a chapter 9 case so municipalities would have continued access to funding. S. Rep. No. 100-506, at 13 (1988). As this Court has previously recognized, §§ 902, 922(d), 927 and 928 expressly protect special revenue financing, so that chapter 9 "insure[s] that revenue bondholders receive the benefit of their bargain with the municipal issuer, namely, they will have *unimpaired rights to the project revenue pledged to them*." Memorandum Opinion, at 40 (citation omitted). Courts have on numerous occasions recognized the importance of rate setting or tax levying covenants to the bargain. *See, e.g.*, *Oppenheim v. City of Florence*, 155 So. 859, 865 (Ala. 1934) (and cases cited therein). As recognized by this

Court and as intended by Congress, chapter 9 is written to protect the integrity of the market for municipal special revenue bonds and to preserve the framework established by state laws. *See* S. Rep. No. 100-506, at 12-13 (stating that Congress amended chapter 9 with the express goal of assuring that holders of special revenue obligations would receive the benefit of their bargain with the municipal issuer).[36] Chapter 9 affirms, rather than abrogates, the framework (and the protections set forth therein) created by state law with respect to special revenue obligations. Accordingly, nothing in chapter 9 preempts Alabama state law regarding special revenue financing.

4. The Validation Order, District Court Order, and Receivership Order confirm the Trustee's right to enforce the County's obligation to set rates at a level sufficient to repay the Indebtedness.

Three separate orders confirm that the Trustee has the right to enforce the County's obligations to set rates at a level sufficient to repay the Indebtedness. First, at the request of the County, the Jefferson County Circuit Court (the "***Circuit Court***") validated and confirmed the Indenture and all covenants, agreements, provisions and obligations of the County relating to the issuance of the Warrants. Validation Order, at 3-15. The Validation Order was not appealed and, consequently, "[s]hall be forever conclusive as to the validity of [the Revenue Covenant] against the [County] and against all taxpayers and citizens thereof, and the validity of [the Revenue Covenant] shall never be called in question in any court in [Alabama]." Ala. Code § 6-6-755.[37] As recognized by the Circuit Court, "[t]he County and its taxpayers and citizens are

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[36] The Congressional intent in approving the 1988 Amendments was to clarify and preserve, rather than abrogate, existing property rights. *See* S. Rep. No. 100-506, at 14-15. Thus, based on the legislative history, it is clear that Congress intended for the liens on special revenues to remain in place unaltered. *See* H.R Rep. No. 100-1011, at 4122 (§ 928 eliminates risk of avoidance).

[37] *See also Se. Meats of Pelham, Inc. v. City of Birmingham*, 895 So. 2d 909 (Ala. 2004) (if a validation proceeding is not appealed, a party may not attack, directly or otherwise, any action validated thereby); *Hillard v. City of Mobile*, 47 So. 2d 162, 164-65 (Ala. 1950) (validation proceeding "sets up a statutory estoppel as to the validity of

precluded from challenging the validity of the covenants in and provisions of the Indenture by the order of the Jefferson County Circuit Court entered August 24, 2001, which order validated the provisions of the Indenture and the [Warrants]."[38] Receivership Order, at 5, ¶ 15. Because the Warrants, Indenture, and all covenants contained therein (including the Revenue Covenant) have been validated, they are forever conclusively determined to comply with Alabama law and are enforceable against the County.[39]

Second, the United States District Court for the Northern District of Alabama (the "***District Court***") and the Circuit Court confirmed that the County could cede its ratemaking authority according to the terms of the Indenture. Both courts considered the substantial authority presented by the Trustee establishing that Alabama law not only permits the appointment of rate setting receivers over utility systems, but that Alabama courts have been approving such receivers for decades. *See, e.g.*, *Bankhead v. Town of Sulligent*, 155 So. 869 (Ala. 1934); Ala. Code § 6-6-620. In a memorandum opinion, the District Court found that the County was authorized to enter into the Revenue Covenant. *The Bank of New York Mellon v. Jefferson Cnty., Ala.*, No. 2:08-cv-01703, Memorandum Opinion [Dkt. No. 100], at 4 (N.D. Ala. June 12, 2009) (the "***District Court Order***"). In turn, the Circuit Court found that § 13.2(c) of the Indenture, which provides for the appointment of a receiver with rate setting powers, was

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such obligations against the unit issuing them, and against all taxpayers and citizens thereof, and the validity of such obligations or of the tax or other means provided for their payment.") (internal quotation and citation omitted); *MacMahon v. Baumharer*, 175 So. 299, 304 (Ala. 1937) (same).

[38] This validation by the Circuit Court applied to the Indenture and the first four supplemental indentures. Validation Order, at 3, ¶ 4; *Id.* at 15, ¶¶ 13, 14; *Id.* at 16, ¶ 1(b). The Revenue Covenant is contained in the original Indenture and was thus validated.

[39] The Trustee's remedies, ***including the right to appoint a receiver with rate making authority***, were also validated in the Validation Order. As a result, the County cannot challenge the validity of the Trustee's remedies and this Court is precluded from disturbing the findings set forth in the Validation Order or otherwise determining that the remedy of a receiver with rate making authority is not permitted under Alabama law. *See Rooker v. Fidelity Trust Co.*, 263 U.S. 413 (1923); *D.C. Ct. of Appeals v. Feldman*, 460 U.S. 462 (1983); *In re Federated Dep't Stores, Inc.*, 226 B.R. 191, 193 (Bankr. S.D. Ohio 1998).

valid and enforceable under Alabama law. Receivership Order, at 5, ¶¶ 14, 15. The County had exercised its rights to set rates by entering into the Indenture, which included the Revenue Covenant, and the Circuit Court recognized that the County could not ignore its obligations to the Trustee and the Warrantholders, and actually appointed a receiver with rate setting powers. *Id.*, at 8-13.[40] Together, the Receivership Order and District Court Order confirm that which was validated in the Validation Order – that the County had the power to contractually bind its ratemaking authority and did so according to the terms of the Indenture. The County may not now use chapter 9 to fundamentally alter its contractual and statutory obligations and commitments under state law in a way that robs the Trustee and Warrantholders of the ability to ensure that their interests are not being impaired without compensation.[41]

B. The Trustee can enforce the Indenture, including the Revenue Covenant, in an Alabama state court.

The County argues that the Alabama state courts do not have the power to require the implementation of higher rates sufficient to repay the Warrants[42] because: (i) the Trustee is seeking to invalidate a lawful rate;[43] (ii) a lawful rate structure can only be challenged if it is

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[40] The Receivership Order is a final order for purposes of claim and issue preclusion. *See Mitchell v. Williams*, 86 So. 2d 369 (Ala. 1956); Ala. Code § 12-22-9; Ala. R. App. P. 4(a)(1)(B) (providing an immediate right to appeal any interlocutory order appointing or refusing to appoint a receiver within fourteen days); *see also First Ala. Bank of Montgomery, N.A. v. Parsons Steel, Inc.*, 825 F.2d 1475, 1480 (11th Cir. 1987) ("Alabama equates finality for purposes of preclusion with appealability"); *N. Ala. Anesthesiology Group P.C. v. Zickler*, 154 B.R. 752, 765 n.36 (N.D. Ala. 1993) ("Appealability should be equated with finality for purposes of res judicata and collateral estoppel" under Alabama law); *Greene v. Jefferson Cnty. Comm'n*, 13 So. 3d 901, 911 (Ala. 2008) (stating judgment becomes final for *res judicata* purposes after the time for filing an appeal has elapsed); *Saxon v. Coosa Cnty.*, 628 So. 2d 398, 401 (Ala. 1993) ("decision is considered a final judgment for preclusion purposes when such decision is appealable.").

[41] The fact that the Trustee has prevailed before in an Alabama state court demonstrates that the Trustee is likely to succeed on the merits if granted relief from the automatic stay.

[42] Again, the County boldly seeks to expand its powers by attempting to limit the rights of the Trustee and Warrantholders to protect their property interests.

[43] The County continually seeks to recharacterize the relief requested by the Trustee as a challenge to the rates adopted by the County on November 6, 2012, when the relief requested by the Trustee is the ability to employ

arbitrary and capricious (*i.e.*, contrary to law, not supported by substantial evidence on the record, or willful and unreasonable without consideration or in disregard of the facts or law); (iii) the Trustee, being limited only to the County's Record (as defined herein), will have the burden of proving that the County's rate structure is invalid; and (iv) any remedy the Trustee may have in state court is preempted by the Bankruptcy Code. Each of these arguments fails. As discussed below, (a) the Trustee has valid remedies to enforce compliance with the terms of the Indenture in Alabama state court, (b) an Alabama state court is capable of granting the relief sought by the Trustee,[44] and (c) such remedies have not been preempted by the Bankruptcy Code.

1. Alabama courts will not defer to the County's rates in determining whether the County has complied with its rate obligations.

Contrary to the County's assertions, upon obtaining relief from the automatic stay, the Trustee will be able to successfully seek redress from an Alabama state court because the County's rate is contrary to Alabama law and the Indenture. Alabama courts are not required to defer to the County in determining whether the County's actions are lawful or in requiring the County to comply with its obligations under the Indenture and Alabama law. Although Alabama courts have generally recognized that rate making is legislative and, consequently, courts will not substitute their judgment for that of the rate maker,[45] that rule does not prevent a court from determining whether a legislative decision is contrary to law. Indeed, when the question posed

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remedies provided by the Indenture to increase (not invalidate) the System's rates, which can only be done in an Alabama state court.

[44] Prior to this case the Trustee had obtained relief in an Alabama state court; however, the automatic stay has temporarily suspended the Receiver's authority over the System and provided the County with the ability to implement a litigation strategy in an attempt to reduce the value of the Trustee's property rights under the Indenture and to force a restructuring of the Indebtedness. This strategy is not sanctioned by Alabama law or the Bankruptcy Code.

[45] *City of Birmingham v. S. Bell Tel. & Tel. Co.*, 176 So. 301, 304 (Ala. 1937); *Leeds*, 675 So. 2d at 354-55.

to the court is whether the rate maker complied with its state law obligations and acted within authority given to it by the state, the court may properly act for the purpose of protecting constitutional rights and holding the exercise of rate setting within its constitutional limits. *S. Bell Tel. & Tel*, 176 So. at 305; *Leeds*, 675 So. 2d at 355; *see also* 12 McQuillin Mun. Corp. § 34:186 (3d ed.) (a court is not making a rate schedule by determining the validity and amount of rates or by compelling a city to do its duty to adopt a rate schedule). As explained by the *Southern Bell* court:

> [T]he Constitution fixes limits to the rate-making power by prohibiting the deprivation of property without due process of law or the taking of private property for public use without just compensation. When the Legislature acts directly, its action is subject to judicial scrutiny and determination in order to prevent the transgression of those limits of power.

S. Bell Tel. & Tel., 176 So. at 305 (quoting *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38, 51-52 (1936)).

This concept has also been recognized by the United States Court of Appeals for the Seventh Circuit, which explains that a municipality is not exercising discretion when it refuses to perform an act it is under an obligation to perform. *Connett v. Jerseyville*, 125 F.2d 121, 124 (7th Cir. 1942). Accordingly, when a municipality refuses to satisfy its legal obligations, such refusal is necessarily arbitrary and contrary to law, and it is the court's duty to compel the municipality to perform. *Id.* (noting that when a court compels a municipality to perform its legal duties, the court is not improperly controlling the municipality's discretion because the municipality has no discretion to abrogate its obligations). Based upon the foregoing, a state court may unquestionably review the County's rate structure to determine whether the County exceeded its constitutional and statutory limitations – *i.e.*, whether the County's rate structure complies with Amendment 73, Act 619, Chapter 28 of Title 11 of the Alabama Code and the

Indenture – and may compel the County to comply with its legal obligations to set appropriate rates.

The County's reliance upon *Pilcher v. City of Dothan*, 93 So. 16 (Ala. 1922) does not support a different result. *Pilcher* stands only for the proposition that an Alabama state court "cannot inquire into the motives of the members of the government, for the purpose of determining the validity of the government's [legislative] acts…." *Id.* at 18-19 (refusing to substitute its judgment for that of city where city acted within scope of its authority by approving a water plant with more capacity than needed to service its inhabitants). *Pilcher* is inapposite to this case – prior to passing the Resolution, the County had ***already*** exercised its discretion by entering into the Indenture containing the Revenue Covenant, and the County does not have discretion to ignore its legal obligations.[46] Importantly, the Trustee asserts that the County acted ***outside its authority*** because the County ***must*** set rates in accordance with Amendment 73, Act 619, Chapter 28 of Title 11 of the Alabama Code, and the Indenture. Accordingly, even if *Pilcher* applied, lifting the automatic stay here would be consistent with its holding, as a state court may (and should) review the County's rate structure to determine whether the County complied with its contractual, statutory, and constitutional obligations, acted within the powers granted to it under the Alabama constitution and state statutes, and protected the constitutional and property rights of the Trustee and the Warrantholders.[47]

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[46] This point is highlighted by the typical remedies employed by utility customers for enforcing rate making authority or challenging rate structures such as the appointment of a receiver or mandamus. *See Ex parte Stewart*, 74 So. 3d 944, 946-47 (Ala. 2011).

[47] Nor would judicial review of the County's actions be limited to the Resolution and the County's Record (as defined herein) due to the Alabama Administrative Procedure Act (the "***AAPA***"). The AAPA expressly applies only to "Agencies." Ala. Code § 41-22-2(d). And, the definition of "Agency" specifically excludes counties. Ala. Code § 41-22-3(1); *see also Jefferson Cnty. v. Ala. Criminal Justice Info. Ctr. Comm'n*, 620 So. 2d 651, 652 (Ala. 1993) (stating that a county is a political subdivision of the state of Alabama, not an agency of the state). Therefore, because the AAPA does not apply to the County, an Alabama state court would for this reason also not be prohibited from reviewing the County's rate structure.

The decision in *Marshall Durbin & Co. of Jasper, Inc. v. Jasper Utilities Board*, 437 So. 2d 1014 (Ala. 1983) does not support the County's position either. In *Marshall Durbin*, the Supreme Court of Alabama did state that the actions of the utilities board were attended with a ***presumption*** of validity. *Id.* at 1018. The *Marshall Durbin* court also found that the trial court, in reviewing the rates to see whether the board acted "arbitrarily, ***unlawfully*** or unreasonably," applied the correct standard for reviewing the reasonableness of rates. *Id.* at 1019 (emphasis added). However, upon reviewing the actions taken by the utilities board, the *Marshall Durbin* court found that the utilities board had indeed acted unlawfully, explaining:

> Again, we are of the opinion that the Board set forth a reasonable ***rate structure*** and administrative procedure in the 1976 resolution, but that the Board failed to follow the [rate structure] set forth therein. ***We hold that in administering the lawfully enacted rate structure a municipal board must follow its own rules***.

Id. at 1022 (emphases added) (citing *Vitarelli v. Seaton*, 359 U.S. 35 (1959)). Similarly, in this case, the County exercised its legislative authority to promulgate a rate structure by entering into the Indenture and agreeing to the Revenue Covenant – *i.e.*, the County promulgated a rate structure tied to paying the amount of the Indebtedness. Indenture, § 12.5(a). The Indenture was then validated and, as a part of the Indenture, the Revenue Covenant was found reasonable. Validation Order, at 3-15. The County has now set the System's rates without any consideration of the Revenue Covenant or Indenture or the System's debt obligations and prepared reports on the cost of a hypothetical system that are not only seriously flawed, but were not even reviewed by the County's rate consultants. Such actions are not only unlawful, but arbitrary as well. Now, like in *Marshall Durbin*, the County cannot fail to follow the Revenue Covenant – the County's properly enacted and validated rate structure – as such action is unlawful. *Id.* at 1022-23, 1026 (finding rates contrary to properly enacted rate structure to be invalid and awarding damages to utility customer). If the County is allowed to engage in such activity under cover of

the automatic stay, the County will have improperly used this Court to expand its rate setting powers beyond the limits allowed by Alabama law.

2. Even if the County's rate is "lawful," the County is not entitled to deference because it was not acting in its governmental, or legislative, capacity.

Even if the County's rate is "lawful," the County's decision is not entitled to deference because it was acting in a proprietary, rather than governmental, capacity. The Eleventh Circuit describes the distinction between proprietary and governmental roles as follows:

> Proprietary governmental functions include essentially commercial transactions involving the purchase or sale of goods and services and other activities for the commercial benefit of a particular government agency. Whereas in its sovereign role, the government carries out unique governmental functions for the benefit of the whole public, in its proprietary capacity the government's activities are analogous to those of a private concern.

FDIC v. Harrison, 735 F.2d 408, 411 (11th Cir. 1984). Once a municipality enters into a contract, it has exercised its legislative authority and begins acting in a proprietary nature with respect to its performance under the contract, including taxing or rate setting activities required by the contract. As set forth above, when a municipality borrows money and contracts to repay it with interest, the municipality acts as a private person, not as a sovereign. *U.S. Trust Co.*, 431 U.S. at 25 n.23; *see also City of Selma*, 964 So. 2d at 20, 23 (city acting in proprietary capacity when it operates a public utility); *Mitchell v. City of Mobile*, 13 So. 2d at 667 (ownership and operation of a utility is a proprietary function); *Birmingham Waterworks*, 211 F. at 501 (city acting proprietary capacity when contracting) (citing *Mitchell v. City of Gadsden*, 40 So. at 350); *Bessemer*, 44 So. at 667 (in entering into a contract for water, the city acted in its proprietary capacity). In attempting to circumvent and otherwise impair its obligations under the Indenture regarding the operation of the System (which is a utility), the County has also acted in its proprietary function. Therefore, the County would not be entitled to deference.

3. Even if the County's actions are not proprietary, they are, at most, administrative and still not entitled to deference.

Even if this Court determines that the County's actions were not proprietary, the County's actions with respect to the System's rates have been, at most, administrative and still not entitled to deference. County commissioners typically have both legislative and administrative responsibilities. *Dillard v. Crenshaw Cnty.*, 831 F.2d 246, 252 (11th Cir. 1987). In Alabama, the deference to which the County asserts it is entitled is reserved for legislative actions. *See, e.g.*, *Marshall Durbin & Co. of Jasper, Inc. v. Jasper Utils. Bd.*, 437 So. 2d at 1019 (granting deference based upon basis that action was legislative); *see also M & N Materials, Inc. v. Town of Gurley (Ex parte Simpson)*, 36 So. 3d 15, 30 (Ala. 2009) (deference only appropriate where actions are inherently legislative (policy-*making*) as opposed to administrative (policy-*applying*)); *see also Smith v. Lomax*, 45 F.3d 402, 406 (11th Cir. 1995) (legislative acts involve policymaking, while administrative acts apply existing policies).

While the County may have exercised legislative authority when it authorized the issuance of the Warrants and the execution of the Indenture (which included the Revenue Covenant), the County was thereafter bound to comply with the Indenture and became bound not to impair the contract or to take the Trustee's and Warrantholders' property without due process and just compensation. *See Von Hoffman*, 71 U.S. at 555 ("[W]here a State has authorized a municipal corporation to contract and to exercise the power of local taxation to the extent necessary to meet its engagements, the power thus given cannot be withdrawn until the contract is satisfied."); *Farson*, 72 So. at 615 (once the county enters a binding contract, "[t]he question passed beyond the field of discretion and became one of plain duty to carry out the agreement solemnly made"). At this stage, the County's role in implementing rates in accordance with the

Indenture, if not a proprietary task, is, at most, a policy *applying* task. As recognized by the Supreme Court of Alabama in *Farson*:

> as the commissioners' court had full power to enter into the contract and agree to levy this special tax for this particular purpose, and that as such agreement is valid and binding ***and a most material part of the contract***, it became the legal duty of the court to levy the tax and have the money so collected appropriated to the purpose for which it was pledged. The contract being binding, ***the question passed beyond the field of discretion and became one of plain duty to carry out the agreement solemnly made***.

Farson, 72 So. at 615 (emphasis added). Once the County entered into the Indenture and agreed to the Revenue Covenant, the question of compliance passed beyond the field of discretion and became one of plain duty – *i.e.*, one of ***applying*** policy for which the County would still not be entitled to deference.[48]

4. The Trustee is entitled to, and was not afforded, due process.

Even assuming, *arguendo*, that the Trustee is not entitled to relief based on the foregoing, the County's arguments fail for the additional reason that the Trustee was not afforded the due process to which it is entitled. The due process clause is made applicable to states and their municipalities by the Fourteenth Amendment to the United States Constitution, and requires that parties be given notice and a meaningful opportunity to be heard prior to the deprivation of their property rights. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950); *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976); *Lachance v. Erickson*, 522 U.S. 262, 266 (1998). "[D]ue process is flexible and calls for such procedural protections as the particular

[48] To the extent the County argues that the rate was voted upon or that the machinations of legislation were implemented, those actions alone do not convert the Commissioners' actions from administrative actions to legislative actions entitled to immunity. *Lomax*, 45 F.3d at 406 (the case law is clear that voting, by itself, does not create a legislative action entitled to immunity). *See also Bryant*, 712 F. Supp. at 890-92 (same); *Dyas v. City of Fairhope*, No. 08-0232, 2009 WL 3151879, at *4-5 (S.D. Ala. Sept. 24, 2009) (same and employing "the tools typical of the legislative process" does not convert an administrative action to a legislative one).

situation demands." *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972). However, "[t]he fundamental requirement of due process is the opportunity to be heard at a meaningful time and in a meaningful manner." *Mathews*, 424 U.S. at 333. The following elements are essential: (i) notice of a proposed action to be taken; (ii) a neutral arbiter; (iii) an opportunity to make an oral presentation; (iv) a means of presenting evidence; (v) an opportunity to cross-examine sworn witnesses; (vi) an opportunity to respond to written evidence; (vii) the right to be represented by counsel; and (viii) a decision based on the record with a statement of reasons for the result. *Jasin v. Michael, Best & Friedrich, LLP*, F. App'x 575, 578-79 (3d Cir. 2011) (quoting *Rogin v. Bensalem Twp.*, 616 F.2d 680, 694 (3d Cir. 1980)).

While the County's failure to set rates consistent with the Indenture and Alabama law should be the end of the analysis, if a court was still inclined to review the record, it would determine that the Trustee was never given the opportunity to be heard ***at a meaningful time*** and ***in a meaningful manner***. Specifically, while the County held three "hearings" regarding the System's rates and has fashioned a "record" (the "***County's Record***"), the County's witnesses were not placed under oath and the Trustee was not apprised of the rate the Commission intended to propose or the methodology the Commission intended to use in its rate setting. Further, the Trustee was not provided the opportunity to call its own witnesses, cross-examine the County's witnesses, or refute the "evidence" proffered by the County. As the evidence will show, the County had already reached a decision regarding the System's rates prior to the conclusion of the hearings.[49] Based upon the foregoing, the Trustee was denied due process, yet net System Revenues that should be generated and paid to the Trustee are being taken by the County's

[49] In fact, the entire rate-making process appears to have been orchestrated by the County's counsel as part of a broader litigation tactic to impermissibly impair the Indebtedness or otherwise force improper and unnecessary concessions from the Warrantholders.

actions in violation of the protections of the Indenture and Alabama law. The Trustee would still be entitled to challenge them in an Alabama state court.

5. The Bankruptcy Code does not preempt the remedies available to the Trustee in state court.

As set forth in § I(A)(3), *supra*, the Bankruptcy Code does not preempt the state law remedies available to the Trustee under the Indenture in an Alabama state court. Considering the foregoing, the Trustee will be able to seek redress in an Alabama state court upon the entry of an order granting relief from the automatic stay.

II. The County is violating Alabama law in order to collaterally attack the Indebtedness.

The automatic stay imposed by § 362 is designed to provide a debtor with a "breathing spell" to develop and propose a plan to repay its obligations in accordance with the requirements and policies of the Bankruptcy Code. *See, e.g.*, *In re Stuart*, 402 B.R. 111, 124 n.17 (Bankr. E.D. Pa. 2009) (citing *Maritime Elec. Co. Inc. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1991)). However, when a debtor uses the automatic stay to harm its creditors and pursue a goal contrary to the Bankruptcy Code, there is no valid purpose justifying restraining the creditor from protecting its rights and property interests in state court. *Id.* In other words, a debtor cannot use the automatic stay as both a sword and shield. Here, however, the County is attempting to do just that. The Indebtedness held by the Trustee and Warrantholders and the lien securing it were valid upon issuance under the specific terms of § 11-28-6 of the Alabama Code[50] and have been validated by court order under a separate validation proceeding. Accordingly, the Indebtedness and the lien securing it represent valid and enforceable

[50] Section 11-28-6 of the Alabama Code states, in pertinent part, that "warrants and the interest thereon shall, from and after the date of their lawful issuance, be deemed to be allowed claims against the county by which they were issued and against any pledged fund so pledged therefor."

obligations of the County.[51] Additionally, the Indebtedness (including the terms of the Indenture) and the lien securing it have been confirmed by at least two further court orders: (i) the District Court Order;[52] and (ii) the Receivership Order.[53] Since the County cannot attack the validity of the Indebtedness or the terms of the Indenture, it is attempting to reduce the Indebtedness collaterally by reducing the System Revenues,[54] the only source of repayment available to the Trustee and the Warrantholders.

The County's arguments in support of ignoring the Indebtedness as part of the basis for determining an appropriate rate include: (i) the Revenue Covenant is a contractual right, not a property right, and is not a part of the pledge by the County under the Indenture; (ii) Alabama law does not make debt service a main determinate of sewer rates and the requirement that rates be based on debt repayment applies only to bond debt, not other types of debt; (iii) a disconnect exists between costs incurred by the County for the System and the facilities built requiring a rate base determined using a "used and useful" standard; and (iv) the Revenue Covenant (§ 12.5(a) of the Indenture) and the Rate Covenant (§ 12.5(b) of the Indenture) cannot be enforced due to the acceleration of the total amount due under the Indenture. Each of these arguments fails because each is based upon misconstrued and improper authority, and the County's actions violate the Fifth Amendment to the United States Constitution.

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[51] *See* Validation Order.

[52] District Court Order, at 4.

[53] Receivership Order, at 5, ¶ 15; Receivership Order, at 8, ¶ 2.

[54] Most of the work performed by the County's experts, Eric Rothstein and CH2M Hill, is designed in furtherance of this collateral attack on the Trustee's and Warrantholders' property rights under the guise of supporting the rate structure and rate increase passed by the County on November 6, 2012. Each of their seriously flawed reports is misleading and fails to support the rate base the County is required to use under Alabama law and the Indenture.

A. The Trustee has property rights in the System Revenues and financial covenants related thereto.

The Trustee has property rights, including a lien on net System Revenues, under the Indenture and Alabama law that are protected by the Bankruptcy Code and United States Constitution. As recognized by this Court in the Memorandum Opinion, "absent a provision of the Bankruptcy Code that requires a different treatment from what state law would dictate, a 'federal bankruptcy court should take whatever steps are necessary to ensure that the mortgagee [lienholder] is afforded in federal bankruptcy court the same protection he would have under state law if no bankruptcy had ensued.'" Memorandum Opinion, at 17 (quoting *Butner*, 440 U.S. at 56 (alteration in original)). When the Warrantholders loaned money to the County pursuant to the terms in the Warrants and Indenture, the Trustee and the Warrantholders relied on the County's exercise of its powers as set forth in the Indenture and as further defined by Alabama law to protect the value of their property rights in the System Revenues.

Under the Indenture and pursuant to Alabama law, the Trustee has constitutionally and statutorily protected property rights in, *inter alia*, the System Revenues and the financial covenants attendant thereto. As recognized by this Court, the County pledged the System Revenues to the Trustee under, and according to the terms of, the Indenture and Alabama law. Memorandum Opinion, at 35. Under Alabama law, rights in a contract, including monetary rights, are treated as property rights. *See, e.g.*, *Randall v. H. Nakashima & Co., Ltd.*, 542 F.2d 270, 273-74 (5th Cir. 1976) (finding right to payment under a contract was a property right under Alabama law).[55] In addition, the Supreme Court of the United States has held that financial covenants such as the Revenue Covenant constitute property rights protected by the United

[55] Myriad courts have held that valid contract rights constitute property rights. *See, e.g.*, *Lynch v. United States*, 292 U.S. 571, 579 (1934) (stating that valid contracts are property protected by the Fifth Amendment to the United States Constitution); *Lion Raisins, Inc. v. United States*, 416 F.3d 1356, 1370 (Fed. Cir. 2005).

States Constitution. *See, e.g.*, *U.S. Trust Co.*, 431 U.S. at 19.[56] Moreover, this court found that the issuance of warrants and the pledge of a definite fund to their payment is, in effect, a sale of the ***anticipated revenue*** to be derived from the allocated funds. Memorandum Opinion, at 35 (citing *Isbell v. Shelby Cnty.*, 180 So. 567, 569 (Ala. 1938)) (emphasis added). And, this court recognized that Congress intended to "insure that revenue bondholders receive the benefit of their bargain with the municipal issuer, namely, they will have ***unimpaired rights to the project revenue pledged to them***." *Id.* at 40 (emphasis in original, citation omitted). Based upon the foregoing, it is clear that the Trustee has property rights in the System Revenues and the various covenants that were bargained for to protect that source of payment. Thus, the Trustee has constitutionally and statutorily protected property rights in the value of the System Revenues.

B. The extent of the Trustee's property rights in System Revenues are defined by the terms of the Indenture and Alabama law.

The Trustee's constitutionally and statutorily protected property rights in the System Revenues arise from the Warrants and Indenture, and are defined by Alabama law. *Clews v. Lee Cnty.*, 2 Woods 474 (C.C. Ala. 1874) (the law existing at the time of issuance is a part of the contract as if the law was written upon the face of the Warrants). The net System Revenues are the most critical part of the sewer financing because the Trustee and Warrantholders must look only to pledged assets as a source for repayment of the Indebtedness. Under Chapter 28 of Title 11 of the Alabama Code, the County issued the Warrants from 1997 to 2003 to finance extensions to and the repair of the System. Starting with the Indenture, and through the course of eleven supplemental indentures, the County agreed to payment terms and secured payment of the Warrants by pledging the System Revenues to the repayment of the obligations evidenced by the

[56] *See also Farson*, 72 So. at 615 (finding financial covenant to be "a most material part of the contract").

Warrants.[57] Chapter 28 of Title 11 of the Alabama Code requires that the sole source of repayment of the Warrants, as limited recourse warrants, is to come from the System Revenues.[58] Ala. Code §§ 11-28-2, 11-28-3.

An essential portion of the Indenture is the County's obligation under the Revenue Covenant, which states:

> The County hereby covenants and agrees to fix, revise and maintain such rates for services furnished by the System as shall be sufficient (i) to provide for the payment of the interest and premium (if any) on and the principal of the [Warrants], as and when the same become due and payable, (ii) to provide for the payment of the Operating Expenses and (iii) to enable the County to perform and comply with all of its covenants contained in the Indenture.

Indenture, § 12.5(a).[59] The Revenue Covenant fixed the System's rates at rates necessary to pay the Indebtedness as it becomes due. Once the County defaulted under the Indenture, the Trustee was entitled to exercise its remedies under § 13.2 of the Indenture. Those remedies supplement the Revenue Covenant so the System's rates can continue to be set at a level sufficient to pay the Indebtedness while the Trustee has the benefit of other protections such as a receiver or the ability to seek a writ of mandamus.

Under § 13.2(c) of the Indenture, the Trustee is entitled to the appointment of a receiver

> [W]ith power to fix and charge rates and collect revenues sufficient to provide for the payment of the [Warrants] and any other obligations outstanding against the System or the revenues thereof and for the payment of expenses of operating and maintaining the

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[57] The aggregate of the Warrants issued between 1997 and 2003 is $3,685,150,000.00.

[58] Because of the nature of the Warrants – *i.e.*, limited recourse – as an integral part of the bargain with the Warrantholders, the County covenanted to set the rates on the System so as to generate System Revenues sufficient to pay, among other things, the Indebtedness as it came due and owing. *See* Indenture, § 12.5.

[59] The Revenue Covenant under § 12.5(a) of the Indenture is different from the "Rate Covenant," which refers to § 12.5(b) of the Indenture. The Rate Covenant is in the nature of a debt service coverage financial covenant, while the Revenue Covenant is a requirement to set the System's rates at a level sufficient to pay the Indebtedness.

> System and with power to apply the income and revenues of the System in conformity with the Act and the Indenture.

Indenture, § 13.2(c). Similarly, if the Trustee chooses to leave the County in possession of the System but to compel the County to act by mandamus, the Trustee is entitled to compel "the fixing of sufficient rates . . . , as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce its rights and the rights of the [Warrantholders] hereunder." Indenture, § 13.2(b). In each case, the System's rates shall be fixed either by a receiver at a level sufficient to pay the Warrants, or by mandamus at a level determined to be most effectual to enforce the Trustee's rights to payment of the Warrants. Notably, neither an Event of Default nor an acceleration eliminates the Revenue Covenant or the County's statutory and constitutional obligations of the County to pay the Indebtedness.[60]

In construing rate agreements by municipalities, Alabama courts have employed general rules of contract construction in determining the level of rates required. For example, in *Birmingham Waterworks*, the United States District Court for the Northern District of Alabama construed a rate agreement to determine whether the parties intended to fix a ceiling on the maximum rate the utility would be allowed to charge or to fix the actual rate the utility was required to charge. *Birmingham Waterworks*, 211 F. 497 (N.D. Ala. 1913). The court recognized the power of the city to agree to fix a rate by contract and then turned to interpretation of the contract language. *Id.* at 503-04. The Court found the contract ambiguous because it provided that certain flat rates "shall never exceed" a schedule, but provided that for metered rates "[t]he company shall have the right to charge" rates not exceeding those set forth

[60] The County argues it can avoid its obligations to comply with the Revenue Covenant by employing and relying on a utility rate consultant under § 13.1(b) of the Indenture. Such a reading of the Indenture is nonsensical. This provision only applies to the Rate Covenant and does not operate to cure failure to comply with the Revenue Covenant, payment obligations, or other defaults.

in a schedule. *Id.* at 504. After reviewing the language and considering the circumstances present at the time of contracting, the court found that the parties intended to provide the water company with a right to charge rates fixed by the agreement, not just set a ceiling on the maximum to be charged. *Id.* at 512.

In *State ex rel. Ferguson v. Birmingham Waterworks Co.*, 51 So. 354 (Ala. 1910), the Supreme Court of Alabama addressed whether a utility with the right to charge for water at a maximum rate allowed by an ordinance would discriminate against consumers if the utility decided to lower rates for its most favored customers. Since the utility was the party that benefited from the higher rates allowed by the ordinance, the court held that the company could charge lower rates to some consumers without any unlawful discrimination. *Id.* at 355. After all, "the consequent discrimination is enjoyed by those having the favored rate at the expense of the Company, and does not impinge upon any rights of consumers generally." *Id.* In essence, the Court held that when a utility was giving away its own property, the consumer paying the higher rates could not complain. The higher paying consumers were only entitled to insist that they not be charged more than the maximum rate allowed by the ordinance-contract. They were not harmed when the utility chose to give away the utility's property. *Id.*

Unlike in the foregoing cases, the language of the Indenture does not leave open the issue of whether it requires the County to fix a sewer rate or merely provides a maximum rate that can be charged. The Indenture contains the type of fixed rate contract recognized as enforceable by *Birmingham Waterworks Co. v. City of Birmingham*, 211 F. 497 (N.D. Ala. 1913). Specifically, the Indenture provides that the System's rates must be fixed at a rate sufficient to pay the Indebtedness and Operating Expenses, and to enable the County to perform under the Indenture. If the County fails to set sufficient rates, the Trustee is entitled to exercise its remedies.

The Indenture does ***not*** merely set a ceiling like in *Ferguson*, 51 So. 354 (Ala. 1910), nor are the facts similar. The System Revenues generated by the System are pledged to the Trustee, constitute a trust, and are impressed with a lien in favor of the Trustee and Warrantholders. Indenture, § 2.1(I); Ala. Code, § 11-28-3. While the utility in *Ferguson* was giving away ***its own property*** when it chose to charge lower rates, the County is taking property belonging to the Trustee and the Warrantholders. The holdings in each of *Birmingham Waterworks* and *Ferguson* support the enforceability of the Revenue Covenant, § 13.2(b), and § 13.2(c) of the Indenture and confirm the recognition given by Alabama state courts to the valuable property rights provided by such rate fixing agreements.

C. Alabama law requires the System's rates to be set based upon the amount of the Indebtedness.

Both Amendment 73 and Act 619 require the System's rates to be based upon the amount of the Indebtedness.[61] The County is correct when it says that Amendment 73 and Act 619 require service charges and sewer rentals to be levied in an amount sufficient to pay amounts owed on bonds. While it is true that strictly speaking "bonds" are not the same as Warrants, the constitutional intent clearly is to require the County to repay its debt. However, the County ignores the remaining language in each of Amendment 73 and Act 619, which makes each applicable to the Indebtedness. Amendment 73 ***also*** provides that service charges or sewer rentals must be levied in an amount sufficient to pay "the principal of and interest on . . . replacements, extensions, and improvements to . . . the sewers and sewerage treatment and disposal plants." The Supreme Court of Alabama has held that the provisions of Amendment 73 generally survive even though the 1958 sewer bonds are no longer in existence. *See Leeds*, 675

[61] The County and the Trustee agree that Amendment 73 and Act 619 govern their rate setting powers with respect to the System.

So. 2d at 355; *Shell v. Jefferson Cnty.*, 454 So. 2d 1331 (Ala. 1984); *Hilgers v. Jefferson Cnty.*, 70 So. 3d 357 (Ala. Civ. App. 2010). Similarly, while Act 619 requires the levying and collection of revenues sufficient to pay indebtedness on bonds, Act 619 ***also*** provides that:

> The power and authority hereby conferred . . . shall be exercised in such a manner as to assure that there shall be levied and collected rentals or service charges in an amount sufficient to pay . . . the cost of replacements, extensions and improvements to . . . sewers and sewerage treatment and disposal plants . . . .

Act 619. In this case, the Warrants were issued to enable the County to fund the expansion and enhancement of, and repairs to, the System. Validation Order, Resolution, at 2, §§ 1(f), 1(g), 1(h); *see also Id*., at 3, § 2. While the Warrants are not bonds, the amount owed on the Warrants – *i.e.*, the Indebtedness – constitutes "the principal and interest on" and "the cost of" replacements, extensions, and improvements to the System. Accordingly, Amendment 73 and Act 619 require the County to set the System's rates at a level sufficient to pay the Indebtedness.

In addition, Chapter 28 of Title 11 of the Alabama Code requires the County to set rates based on the Indebtedness. First, § 11-28-2 of the Alabama Code grants the County "the power from time to time to sell and issue warrants of the [C]ounty for the purpose of paying costs of [the System]." Ala. Code §11-28-2. In addition, § 11-28-2 authorized the County to:

> in its discretion, provide . . . that the warrants shall evidence limited obligation debt of the [C]ounty payable solely from specified pledged funds, in which case the pledged funds shall be irrevocably pledged for the payment of the principal of and interest on such warrants ***as provided in Section 11-28-3***."

Id. (emphasis added). In turn, § 11-28-3 of the Alabama Code provides in pertinent part:

> If the county commission of any county . . . determines to issue warrants under this chapter that are limited obligations of such county payable solely from specified sources, then such county commission may assign and specifically pledge . . . for the payment of the principal of and interest on such limited obligation warrants (as the sole source for the payment thereof) . . . all or any portion of the funds derived from . . . (7) [t]he revenues from any

> revenue producing properties owned, leased or operated by such county, including, without limitation thereto, any water system, sewer system, electric distribution system or other utility.
>
> The pledge of any pledged funds for the payment of the principal of and interest on warrants issued by any county pursuant to this chapter, ***together with any covenants of such county relating to such pledge***, shall have the force of contract between such county and the holders of such warrants.

Ala. Code, § 11-28-3 (emphasis added). These two provisions together authorized the County to issue the Warrants and pledge the System Revenues under the Indenture. Moreover, upon issuing the Warrants, § 11-28-3 of the Alabama Code obligated the County to perform according to the terms of the Indenture, including the Revenue Covenant. *Id.* The Indenture has rate fixing requirements included in the Revenue Covenant as well as enforcement rights included in the receivership remedy set forth in § 13.2(c) of the Indenture and the mandamus remedy set forth in § 13.2(b) of the Indenture. Consistent with Alabama law, the Indenture requires rates to be set at levels sufficient to repay the Indebtedness.

Based upon the foregoing, the Trustee has property rights in net System Revenues at the levels anticipated to be derived as a result of the County's compliance with the Revenue Covenant and other provisions of the Indenture and Alabama law, including, upon an Event of Default, the Trustee's enforcement of the provisions set forth in the Indenture. *See, e.g., City of Ft. Madison v. Ft. Madison Water Co.*, 134 F. 214 (8th Cir. 1904) (where statute provides a municipality with power to generate revenue to meet its obligations under an authorized contract, the power to generate revenue becomes a part of the contract); *Randall*, 542 F.2d at 273-74; *Alfa Mutual Ins. Co. v. Veal*, 622 So. 2d 1292, 1295 (Ala. 1993); *Century Exploration New Orleans, Inc. v. United States*, 103 Fed. Cl. 70, 76 (Fed. Cl. 2012) (contractual rights are cognizable property rights protected by the Fifth Amendment) (citing *Lynch*, 292 U.S. at 579); *Lion Raisins*, 416 F.3d at 1370 (same).

D. The "used and useful" test is inapplicable in this case and does not justify a different result.

Despite the County's legal and contractual requirements to set the System's rates based on the Indebtedness and other costs of service, the County determines in Resolution that:

> [T]he Commission finds and determines that it is appropriate to consider an approach under which the debt service portion of the System's revenue requirement should be estimated based on the indebtedness the County would be servicing had there been no fraud, graft, waste, gross incompetence, and the like in the construction of the System.

Resolution, at 28, ¶ XXX. The County claims that this rate setting approach is "appropriate" based on the advice of Mr. Rothstein who, according to the County, "testified" that:

> [T]he County could look for guidance in how private utilities are regulated such as the concept of disallowing certain imprudently incurred costs. . . . One of the fundamental princip[les] of that is the rate of return is earned on used and useful assets.

Resolution, at 19, ¶ FFF(iii).[62]

In Mr. Rothstein's deposition, however, Mr. Rothstein testified that he did ***not*** recommend that the County employ a rule of prudence or a "used and useful standard" but, rather, he informed the County that such concepts may be helpful. Mr. Rothstein further recognized that the "used and useful" concept was not generally used by government owned utilities ("***GOUs***") and he was aware of no circumstance when it had been so used. Even though the County's own consultant has not recommended the "used and useful" standard be used in the County's rate setting, the County has decided to base its refusal to raise rates on this inappropriate and inapplicable standard. Even if the standard did apply, none of the County's

[62] The County similarly stated that it did not want to prejudge anything before it had all the facts and input of the public and its highly-qualified experts. *First Periodic Status Report Concerning the Sewer Ratemaking Process* [Dkt. No. 1070], Exh. A, at 10:14-11:9. The County even went so far as to represent that it had not yet decided on a proposal. *Id*. at 11:10-21. Notwithstanding this representation, the Trustee will present evidence to this Court suggesting that the Commissioners had, indeed, already made a prejudgment prior to ***any of the public hearings***.

experts have attempted to apply the standard to the County's rate setting process.[63] The County's experts' failure to apply this standard is not surprising. A review of the case law discussing the "used and useful" standard illustrates the inapplicability of this standard to the County's rate setting. The County borrowed $3.6 billion to expand and improve its System but has now decided it should pay back less since it could have allegedly borrowed less originally.

The "used and useful" test does not warrant disregarding debt service in setting the System's rate. Specifically, the "used and useful" test is inapplicable in this case because: (i) application of the test to a GOU is inappropriate because GOUs do not have investors or equity investments; and (ii) it does not have any application in determining whether rates must be sufficient to pay debt service.

1. The "used and useful" test cannot be validly applied to GOUs.

First, application of the "used and useful" test is inappropriate because the issue is not whether the County is entitled to a rate of return on the System in excess of the System's cost of providing service. The "used and useful" test arose in the context of privately (*i.e.*, investor) owned utilities ("***IOUs***") and is derived from Fifth and Fourteenth Amendment concerns and is designed to protect private investors from governmental takings.. *See generally Smyth v. Ames*, 169 U.S. 466 (1898), *overruled on other grounds by Fed. Power Comm'n v. Nat. Gas Pipeline Co. of Am.*, 315 U.S. 575 (1942); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989). The test arose to combat rates that were so low as to be confiscatory with respect to property dedicated by private owners of the IOU to the public use, and to determine the proper ***rate of return for those owners on their***

[63] The County's statement that the "used and useful" standard is an appropriate justification for ignoring the Indebtedness in setting the System's rates and the hiring of experts to develop reports to support this argument without even asking them to apply the standard demonstrates the County's improper attempts to use this bankruptcy case to harm the Trustee and Warrantholders in order to improperly force concessions.

investments. *See, e.g.*, *Ames*, 169 U.S. at 526 (stating issue is whether the rate is set so low so as to constitute an unconstitutional taking); *Hope Natural Gas*, 320 U.S. at 601-03 (discussing proper rate of return for investors); *Duquesne Light*, 488 U.S. at 307-10 (stating that if a rate does not afford sufficient compensation, it is an unjust taking; and, detailing the two tests and how each assures a constitutionally valid rate – *i.e.*, not too low). In the case *sub judice*, the issue is not whether the County is being impermissibly deprived of a return based on the use of its property – there are no investors who could even make such an argument. Rather, the question is whether the County must set its rates at a level sufficient to cover the debt it incurred in constructing the System. In such context, the "used and useful" test has no applicability.

In addition, the "used and useful" test does not have a valid application with respect to GOUs, because GOUs have no equity investors seeking to earn a rate of return ***on investment***. As noted by the *Duquesne Light* court, the test is focused on the rate of return allowable to investors ***on their investment***. *Duquesne Light*, 488 U.S. at 310; *see also Wash. Gas Light Co. v. Baker*, 188 F.2d 11, 18-20 (D.C. Cir. 1951) (focusing on return on investment of investors). When it comes to a GOU, unlike in an IOU, there are no "equity investments" or "equity investors." *Wabash Valley*, 903 F.2d at 449-50 (J. Easterbrook). Consequently, a GOU's rates have nothing to do with the equation between greater risk with higher yield and greater assurance of recovery with lower yield, but, rather, rates are determined based upon the GOU's "costs" – *i.e.*, wages, materials, and debt service. *Id.* In other words, there is no determination to be made with respect to the proper rate of return to be had ***on one's investment***. The "used and useful" test consequently has no applicability in determining appropriate rates for a GOU.

2. The "used and useful" test has no applicability in determining whether a utility may return the cost of capital.

Even if the "used and useful" standard did apply, a proper application of the standard would not lower the rate base by the cost of constructing the improvements which were not "useful." Instead, the standard would be limited to disallowing a return on investment, not a recovery of the principal investment itself. As noted in *Office of Consumer Advocate v. Iowa Utilities Board*, 454 N.W.2d 883 (Iowa 1990) ("***IUB2***"), the "used and useful" standard is derived from United States Supreme Court holdings and stands for the proposition that investors in a utility are entitled to a reasonable return ***on*** the value of property used to render services – *i.e.*, a reasonable return on their investment. *Id.* at 886 (quoting *Office of Consumer Advocate v. Iowa Utilities Bd.*, 449 N.W.2d 383, 386 (Iowa 1989) ("***IUB1***") (quoting *Iowa-Illinois Gas & Elec. v. Iowa State Commerce Comm'n*, 347 N.W.2d 423, 428 (Iowa 1984))). In other words, a utility is entitled to a certain ***rate of return*** based upon the amount of capital invested, which is distinct from recovering the value ***of*** the investment itself, or costs associated therewith. *Id.* at 886-87.

The Supreme Court of Iowa recognized this very distinction in *IUB1*. In *IUB1*, the Iowa Electric Light and Power Company undertook three new electrical generating projects that ultimately were abandoned without ever going into service.[64] *IUB1*, 449 N.W.2d at 384. Following the abandonment of the projects, the utility sought to recover both (a) the amount invested in the projects and (b) a reasonable return on the amount invested. *Id.* at 385. While denying any return *on* the amount invested, the utility board permitted the utility to amortize,

[64] Like with certain incomplete or otherwise abandoned portions of the System, at the time, the projects were commenced based upon anticipated demand. It later became clear that future demand was not meeting projections and, accordingly, the projects were abandoned. *IUB1*, 449 N.W.2d at 384-85.

over a ten-year period, the actual amounts spent toward developing the projects – *i.e.*, recovery ***of*** the amount invested. *Id.* at 384.

On appeal of the utility board's decision, the *IUB1* court began by referring to the origin of the "used and useful" test, stating:

> The "used and useful" standard is derived from United States Supreme Court holdings that a utility is entitled to a reasonable return on the value of property used to render services, but "it is not entitled to have included any property not used or useful for that purpose."

Id. at 386 (quoting *Iowa-Illinois*, 347 N.W.2d at 428 (citing *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470, 475 (1938))). The *IUB1* court then noted that myriad state courts have been confronted with application of the "used and useful" test to situations in which projects were abandoned, and espoused:

> The overwhelming majority of the cases indicate that, although superficially it might seem appropriate, the "used and useful" rule has no proper place in the analysis [of whether costs are recoverable]. The cases flatly reject the notion that we confront a simple rule based on an obvious economic premise (investment risks should be assigned the same investors who would enjoy the advantage of profits). The economic premise goes without saying but does not fit into the analysis [of whether costs are recoverable].

Id. at 386 (citing *People's Org. for Wash. Energy Res. v. Wash. Util. & Transp. Comm'n*, 711 P.2d 319, 332 (Wash. 1985); *Attorney Gen. v. Dep't of Pub. Util.*, 455 N.E.2d 414, 424 (Mass. 1983); *Wis. Pub. Serv. Corp. v. Pub. Serv. Comm'n of Wis.*, 325 N.W.2d 867, 871 (Wis. 1982)).[65] The *IUB1* court continued by stating that "the 'used or useful' argument has more glitter than substantive application" in determining whether costs are recoverable and found that it had application in determining the rate base only – *i.e.*, the value of the property to be used in

[65] The court noted cases holding otherwise, but recognized that all such cases were decided based upon specific statutory language. Such language was not present in the *IUB1* case and is not present in this case.

determining an appropriate ***rate of return on an investment***. *Id.* As noted by the *IUB1* court, "the used or useful rule cannot be applied outside rate base questions without doing violence to the whole scheme of public utility law." *Id*. at 387 (citing *People's Org.*, 711 P.2d at 329). That is, the "used and useful" test has no application in determining whether a utility may recover the cost of its investment, as distinct from earning a rate of return *on the investment*.

Because the "used and useful" test has no application in determining whether a utility may recover the ***cost*** of an investment, the "used and useful" test has no application to a GOU's cash-needs rate setting methodology, which focuses solely on costs, including debt service, and does not build a rate of return into the utility's rates. Consequently, as noted by the *IUB1* court, the "used and useful" test has no place in rate setting per the cash-needs method. As a result, the "used and useful" test is not applicable to GOUs and, therefore, is inapplicable here.[66]

E. The County can comply with the provisions of the Indenture requiring the System's rates to be set based upon the Indebtedness.

The County can comply with the Indenture without violating Alabama law. The County argues in error that the System's rates cannot be set at a reasonable rate and also comply with the

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[66] Application of the "used and useful" test would also breach the County's fiduciary duties to the Trustee and the Warrantholders. The System Revenues constitute a trust fund, placing the County in a fiduciary position. Courts have treated numerous other municipalities as "trustees" of funds held on behalf of municipal bondholders. *See, e.g.*, *State ex rel. Cent. Auxiliary Corp. v. Rorabeck*, 108 P.2d 601, 603 (Mont. 1940) (municipal officials responsible for generating and holding funds to pay bonds are trustees for the bondholders); *Blackford v. City of Libby*, 62 P.2d 216, 217-18 (Mont. 1936) (city is a trustee for warrantholders); *Fidelity Trust Co. v. Vill. of Stickney*, 129 F.2d 506 (7th Cir. 1942) (municipality is trustee of funds where it held funds for payment of special assessments). As a fiduciary, the County owes an undivided duty of loyalty to the Warrantholders. *See Pegram v. Herdrich*, 530 U.S. 211, 224 (2000) (duty of loyalty is the most fundamental duty owed by fiduciary to beneficiaries); *see also Ledbetter v. First State Bank & Trust Co.*, 85 F.3d 1537, 1540 (11th Cir. 1996) (undivided loyalty to beneficiaries is the foremost duty of a fiduciary); *Henley v. Birmingham Trust Nat'l Bank*, 322 So. 2d 688, 698 (Ala. 1975) (fundamental rule of law that a trustee must act in good faith and give undivided loyalty to his trust); *Vill. of Brookfield v. Prentis*, 101 F.2d 516, 520 (7th Cir. 1939) (municipality issuing bonds is trustee of funds for the payment thereof and has all duties of a fiduciary). In carrying out its duty of loyalty, the County must exclude all selfish interest and all considerations of third parties. *See* G. Bogert & G. Bogert, *Law of Trusts & Trs.*, § 543 (Rev. 2d ed. 1980). Imprudent management of a trust can be a breach of a trustee's duties, including loyalty. *Jones v. Ellis*, 551 So. 2d 396, 403 (Ala. 1989). The County's failure to raise rates in accordance with the Indenture and Alabama law conflicts with the County's fiduciary duties.

Indenture.[67] The County's argument is flawed because the County misapplies §§ 12.5(b)(i) and 12.5(b)(ii) of the Indenture. Sections 12.5(b)(i) and 12.5(b)(ii) make up the "Rate Covenant," which obligates the County to maintain certain debt coverage ratios measured by reference to Net Revenues Available for Debt Service and the amount of debt service in a given Fiscal Year. Separate from the Rate Covenant, the County has a continuing obligation to comply with the affirmative requirements set forth in the Revenue Covenant to fix, revise and maintain rates sufficient to pay for the principal and interests on the Warrants, to pay for Operating Expenses, and to otherwise perform and comply with the covenants contained in the Indenture. Section 12.5(a) of the Indenture is not a part of the Rate Covenant under the Indenture, but is instead an independent obligation of the County under the Indenture.

As a result of the County's defaults under the Indenture, the Trustee is entitled to enforce its rights and remedies to have rates increased and System Revenues otherwise enhanced so that the System Revenues can and will pay the System's Operating Expenses and the principal and interest on the Warrants, in full, as quickly as reasonably possible. *See* Indenture, §§ 12.5(a), 13.2(b), 13.2(c). Specifically, upon the occurrence and continuation of an Event of Default:

> The Trustee may, by civil action, mandamus or other proceedings, protect, enforce and compel . . . the fixing of sufficient rates . . .whether for the specific performance of any covenant or agreement herein contained . . . ***or for the enforcement of any other proper, legal or equitable remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce its rights and the rights of the [Warrantholders] hereunder***.

Indenture, § 13.2(b) (emphasis added). Likewise, under § 13.2(c) of the Indenture, the Trustee is entitled to seek the appointment of a receiver with the power to fix and charge rates and collect

[67] Impossibility is no excuse for failing to make an attempt to maximize System Revenues and pay as much of the Indebtedness as is possible. *Perry*, 11 F.2d at 659.

revenues "sufficient to provide for the payment of the [Warrants.]" Indenture, § 13.2(c). Under the current circumstances, the Trustee seeks stay relief to enable it to enforce its remedies with respect to ratemaking in an Alabama state court. Accordingly, the issue of whether the County could comply, and what would be required for the County to comply, with the Rate Covenant in a given fiscal year is immaterial. And, as neither of § 13.2(b) or § 13.2(c) of the Indenture enables the Trustee to implement rates that would achieve an immediate payment of the Warrants, the rates can unquestionably be set at a rate that complies with the terms of the Indenture – *i.e.,* a rate that is sufficient to pay the amount of the Indebtedness in full.

The County can also set a rate that is compliant with Alabama law. Under Alabama law, the only limitation upon the System's utility rate is that it be "reasonable and nondiscriminatory." Amendment 73; Act 619. Historically, Alabama courts have upheld utility rates when they are designed to provide for the operation, maintenance, and extension of the utility system, plus provide for whatever capitalization is required by the debt service of that utility. *Allen v. Jefferson Cnty. Comm'n*, No. CV-2007-716-JLB, Defendant Jefferson Cnty. Comm'n's Supplemental Submission in Support of its Motion to Dismiss, at 3 (Ala. Cir. Ct. May 9, 2008). Further, a municipality has the authority to generate sufficient revenues from its residents to carry out its undertaking to operate a sewer system. *Bd. of Water & Sewer Comm'rs of Mobile v. Yarbrough*, 662 So. 2d 251, 253-54 (Ala. 1995). As recognized by the Supreme Court of Alabama, under Alabama law, a reasonable rate is a rate that generates sufficient revenue to pay debt service and the cost of operating the utility. *See, e.g.*, *Mitchell v. City of Mobile*, 13 So. 2d at 667 ("Reasonable rates may be charged after the [indebtedness] for which they are ear-marked [is] fully paid."). If the System's rates were set at a level sufficient to pay

the Indebtedness, it follows that the System's rates would be *per se* reasonable.[68] Therefore, the County can set a reasonable rate that complies with the Indenture and Alabama law, thereby protecting the Trustee's property rights under the Indenture.

F. The County's actions constitute an impermissible taking in violation of the Fifth Amendment to the United States Constitution.

The County is using the protections afforded by the automatic stay to effectuate an impermissible taking of the Trustee's and Warrantholders' interests in System Revenues that the System should be generating, thereby violating the Fifth Amendment to the United States Constitution. The Trustee's and Warrantholders' property rights include the right to insist that the County set rates based on Alabama law in accordance with the terms of the Indenture, but the Trustee and Warrantholders are currently being deprived of those property rights by application of the automatic stay and the County's refusal to comply with Alabama law. *Ill. Bell Tel. Co.*, 270 U.S. at 591 (stating that property may be as effectively taken by a long and unreasonable delay in setting appropriate rates as by an express, affirmative taking). Even if the County is impairing the Trustee's rights pursuant to the Bankruptcy Code (which it is not), as long recognized, the bankruptcy power must yield to the protections afforded to property rights by the Fifth Amendment. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935). As discussed above, the Trustee has valuable property rights under the Indenture and Alabama law, and the County is impairing the Trustee's property rights without providing compensation to the Trustee for such impairment, or otherwise providing adequate protection. Therefore, the

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[68] Indeed, the County has even taken this position in prior proceedings before the Circuit Court. *See Allen*, No. CV-2007-716-JLB, Defendant Jefferson Cnty. Comm'n's Supplemental Submission in Support of its Motion to Dismiss, at 2-5 (Ala. Cir. Ct. May 9, 2008) (stating that "a utility rate is reasonable if it is related to the costs associated with providing the utility and the payment of debt thereon"). Notably, the Jefferson County Circuit Court agreed, stating that "[t]he Alabama Supreme Court has held time and again that a utility rate is reasonable if it is related to the costs associated with providing the utility *and the payment of debt thereon*…." *Allen*, No. CV-2007-716-JLB, Order, at 8, 14 (Ala. Cir. Ct. Mar. 11, 2009) (emphasis added).

County's use of the stay in connection with its unlawful taking of the Trustee's property rights under the Indenture is without either due process of law or just compensation, and should not be allowed by this Court and constitutes cause warranting relief from the automatic stay.

G. Even if the Trustee does not have a property right in the financial covenants set forth in the Indenture, the County is still impermissibly impairing the Trustee's property rights.

Even if this Court finds that the Trustee does not have a property right in the financial covenants set forth in the Indenture, including the Revenue Covenant, the County's actions would still impermissibly impair the Trustee's property rights under the Indenture and Alabama law. Regardless of whether the Trustee or Warrantholders have a property right in the power to set rates, if the County sets the System's rates contrary to the mandates set forth in the Indenture and under Alabama law, the result is that the Trustee's undisputed property interest in the System Revenues is being depleted and "taken" by the County, which in and of itself constitutes cause for granting relief from the automatic stay.

For example, in *Le Sannom Building Corp. v. Nathanson*, No. 92-civ-8716, 1993 WL 330442 (S.D.N.Y. Aug. 23, 1993), the debtor-landlord borrowed funds, which loan was secured by a lien upon the debtor's building. Notwithstanding the debtor having tenants, the debtor had never collected any rent from those tenants, and as the *Le Sannom* court noted, "it appear[ed] that the [d]ebtor ha[d] made a conscious choice not to generate income from rental of the [b]uilding." *Id.* at *3. The *Le Sannom* court thus affirmed the bankruptcy court's order granting relief from the automatic stay, holding that mismanagement of the debtor's assets such that the interests of creditors was being jeopardized provided "cause" for lifting the stay. *Id.* at *4; *see also Matter of Holly's, Inc.*, 140 B.R. 643, 689 (Bankr. W.D. Mich. 1992) (stating that postpetition act or omission by a debtor resulting in an adverse effect upon the value of collateral provides "cause" for relief from the automatic stay). Like in *Le Sannom*, the County is consciously choosing to

depress System Revenues and this action impairs and jeopardizes the Trustee's and Warrantholders' interests. Accordingly, even if this Court found that the Trustee did not have property rights in the financial covenants set forth in the Indenture, the County's actions, like in *Le Sannom*, would still constitute an impermissible impairment of the Trustee's property rights in the System Revenues and cause would consequently exist to grant relief from the automatic stay.

III. Alternatively, if the Trustee is not granted relief from the automatic stay, the County must provide the Trustee with adequate protection.

Alternatively, to the extent this Court does not grant relief from the automatic stay, it should condition the continuation of the automatic stay upon the County's providing adequate protection to the Trustee. As the Trustee will demonstrate at the hearing to consider the Motion for Relief, this Court should condition the continuation of the automatic stay upon the implementation of a rate structure that will result in an initial and immediate twenty-two percent (22%) increase of System Revenues.

CONCLUSION

For the reasons set forth above, the Trustee is entitled to relief from the automatic stay pursuant to §§ 362(d)(1) and 922(b) or, alternatively, is entitled to adequate protection. Accordingly, the Trustee respectfully requests that this Court enter an order granting it relief from the automatic stay, or, in the alternative, adequate protection, and grant such other and further relief as this Court deems just and proper.

Dated: January 18, 2013

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing was filed and served by the Court's electronic case filing and noticing system to all parties registered to receive electronic notices in this matter and via email or via first class mail as stated below to the following, this 18th day of January, 2013.

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The Bank of New York Mellon Trust Company, N.A. (f/k/a The Bank of New York Trust Company of Florida, N.A.), as registrar, transfer agent and paying agent Attn: Charles S. Northen, IV 505 N. 20th Street Suite 950 Birmingham, AL 35203	Teklinks Inc. 201 Summit Parkway Homewood, AL 35209
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John Plott Company Inc. 2804 Rice Mine Road NE Tuscaloosa, AL 35406	Laboratory Corporation of America 430 South Spring Street Burlington, NC 27215 Attention: Legal Department

/s/ Larry B. Childs
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